No. 277

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Panhandle Eastern Pipe Line Company, petitioner herein, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in the above-entitled cause on March 15, 1963.

OPINIONS BELOW

The original opinion of the panel of the Court of Appeals, dated September 27, 1962 (App. A, pp. 1a-13a, 15a) is not reported. The court's *en banc* opinion, dated March 15, 1963 (App. A, pp. 16a-46a) is reported at 316 F. 2d 659. The opinion of the Federal Power Commission (App. B, pp. 1b-6b) is reported at 25 F.P.C. 550.

JURISDICTION

The judgment of the panel of the Court of Appeals was entered on September 27, 1962 (App. A, p. 14a). The judgment of the Court of Appeals sitting *en banc* was entered on March 15, 1963 (App. A, p. 47a). Panhandle's timely petition for rehearing was denied "on consideration" on April 18, 1963 (R. 131; App. A, p. 48a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether in fixing rates under the Natural Gas Act, the Federal Power Commission may deprive a natural-gas company of the major portion of the benefits of its deferred tax accruals resulting from its election to use accelerated amortization and liberalized depreciation under Sections 167 and 168 of the Internal Revenue Code where such deprivation is contrary to the intent of Congress and represents a reversal of prior judicially approved Commission decisions on which the company had relied.

2. Whether a circuit judge who has advised the President of his intention to retire "to take effect only when the successor you appoint is ready to be sworn in" is an "active circuit judge," within 28 U.S.C. 46(c), qualified to participate and cast the deciding vote in an *en banc* decision issued on the very day the Senate confirms his successor.

STATUTES INVOLVED

The pertinent provisions of Sections 167 and 168 of the Internal Revenue Code are set out in Appendix C, pp. 1c-4c. 28 U.S.C. 46(c) is set out in the text at p. 19.

STATEMENT

Panhandle Eastern Pipe Line Company (Panhandle) owns and operates a natural gas pipeline system extending in a northeasterly direction from Texas to Michigan. The rates charged by Panhandle for the sale of natural gas for

resale in interstate commerce are subject to regulation by the Federal Power Commission under the Natural Gas Act.

By order issued March 20, 1961, the Commission required Panhandle to file interim rates reflecting an over-all return on Panhandle's transmission properties computed by including as a part of Panhandle's capital the accumulated deferred tax accruals resulting from Panhandle's use of Sections 167 and 168 of the Internal Revenue Code and by allowing a return of only 1.5 per cent on such accumulated tax accruals.[1] A panel of the Court of Appeals initially reversed the Commission's order in a 2-1 decision (App. A, pp. 1a-13a, 15a); but on the Commission's petition for rehearing *en banc*, the court in a 5-4 decision reversed the panel decision and affirmed the Commission's order (App. A, pp. 16a-46a).[2]

Sections 167 and 168

In 1950 Congress enacted the accelerated amortization provision which is now Section 168 of the Internal Revenue Code (App. C, pp. 2c-4c).[3] As the legislative history makes clear, this provision was enacted in an effort to induce industry to inject more capital into the economy and to encourage the construction of certain types of facilities. Under this Section facilities may, to the extent that they have been certified by the appropriate agency as emergency, be fully depreciated for federal income tax purposes over a five year period although the property's useful life is much longer. Thus, other factors remaining constant, during the first five years of the useful life of such property, the tax is lower than it would be with normal ("straight-line") depreciation, under which the deprecia-

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[1] On July 20, 1962, the Commission approved an agreement settling all the other issues in this rate case (28 F.P.C. 200 (1962)).

[2] The *en banc* decision here under review was issued on March 15, 1963, the same day as Judge Edgerton's successor was confirmed by the Senate.

[3] Originally enacted as Section 124A.

tion expense is the same for each year of the asset's life. Since the total depreciable book value of any property is unaffected by the depreciation method used, there is, however, no depreciation allowable for tax purposes remaining after the first five years and consequently taxes are higher during the later years of the useful life of such property than they would be under straight-line depreciation.

In 1954 Congress enacted the liberalized depreciation provision of Section 167 of the Internal Revenue Code (App. C, pp. 1c-2c). This provision was also enacted to improve the nation's economy by encouraging expansion of the nation's productive facilities. Under the depreciation methods authorized by Section 167, the depreciation expense allowed for tax purposes during the early years of the life of the depreciable property is greater than that under straight-line depreciation. Thus, as in the case of accelerated amortization, the use of liberalized depreciation results in greater depreciation allowance and lower Federal income taxes than does straight-line depreciation during the early years of the life of the property. And, as in the case of accelerated amortization, this is offset by lower depreciation allowances for tax purposes, and hence higher taxes, in the later years of the property's life.

Thus, neither accelerated amortization nor liberalized depreciation has any net effect, all other factors remaining constant, on a company's tax liability over the life of the property concerned. Their sole effect is to permit a company, during the early years of the property's life, to accrue deferred tax funds which may be invested in productive facilities upon which the company may earn a return.

The Commission's Prior Treatment of Sections 167 and 168

In August 1952, before electing to use Section 168, Panhandle sought a declaratory order from the Commission as to whether it would be allowed to retain the tax benefits under that provision (R. 31). Thereafter the Commission expanded this proceeding into a rule-making proceeding in which Panhandle actively participated. On December 4, 1953 the Commission handed down its opinion, holding that Congress intended the benefits of Section 168 to inure to the taxpayer companies and that none of the benefits were intended to be passed on to their consumers. *Treatment of Federal Income Taxes As Affected By Accelerated Amortization.* 12 F.P.C. 369 (1953).

In reliance on this ruling, Panhandle elected to use accelerated amortization for federal income tax purposes and expanded its facilities as Congress intended with the funds thus accumulated (R. 31). Thereafter, in a proceeding involving Panhandle's rates, it was contended that some of the benefits resulting from Panhandle's use of accelerated amortization should be passed on to its consumers in the form of reduced rates. Adhering to the position taken in the earlier proceeding, the Commission rejected these contentions and fixed Panhandle's rates by using straight-line depreciation for federal income tax purposes in its cost of service (*Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, 81-84 (1954)). In accordance with the policy announced in its earlier ruling, the Commission directed Panhandle to set up a special account for the deferred tax accruals (*Id.* at pp. 83-84) to meet increased taxes which will be experienced in the subsequent life of the property involved. On appeal, the Court of Appeals for the District of Columbia Circuit agreed with the Commission's conclusion as to the Congressional intent and affirmed the allowance of a full return. *City of Detroit* v. *F.P.C.*, 230 F. 2d 810, 822 (1955), *cert. denied*, 352 U.S. 829 (1956). A part of the tax accruals involved in the present case are exactly

the same funds and result from exactly the same facilities as were involved in *City of Detroit*.

With respect to Section 167, after similar rule-making hearings in which Panhandle actively participated as an intervenor, the Commission ruled that both the effect and the Congressional intent with regard to liberalized depreciation (under Section 167) were the same as with regard to accelerated amortization (under Section 168) and concluded that liberalized depreciation should be accorded the same treatment as accelerated amortization. *Amere Gas Utilities Co.*, 15 F.P.C. 781 (1956). Again, it was only after receiving such assurance from the Commission, and in reliance thereon, that Panhandle elected to use liberalized depreciation for Federal income tax purposes and decided to build additional plant facilities with the resulting accruals (R. 31-32).

Subsequently, and through at least September 28, 1960, the Commission continued to adhere to these views. *El Paso Natural Gas Co.*, 22 F.P.C. 260, 265-67 (1959), *aff'd* as to this issue, 281 F. 2d 567 (5th Cir. 1960), *cert. denied*, 366 U.S. 912 (1961); *United Fuel Gas Co.*, 23 F.P.C. 127, 130-31 (1960), *aff'd sub nom. Cities of Lexington, Kentucky, et al.* v. *F.P.C.*, 295 F. 2d 109 (4th Cir. 1961); *Phillips Petroleum Co.*, 24 F.P.C. 537, 570 (1960), *aff'd sub nom. State of Wisconsin* v. *F.P.C.*, 303 F. 2d 380 (D.C. Cir. 1961), *aff'd* U.S. (decided May 20, 1963).

The Order Under Review

On September 10, 1959, Panhandle filed with the Commission, pursuant to Section 4(d) of the Natural Gas Act, schedules of new rates reflecting a 7 percent over-all rate of return on its transmission properties. After hearing, the Commission severed the rate of return issue for immediate decision and on March 20, 1961, issued the interim order here under review (R. 38-43; App. B, pp. 1b-6b).

In this order, the Commission required Panhandle to file interim rates reflecting an over-all return, computed on

the basis of including Panhandle's deferred tax accruals of $11,076,954[4] in its capitalization at a return of only 1.5 percent (R. 38-39, 40; App. B, pp. 3b-4b, 5b). By this means, the Commission reduced the over-all rate of return which Panhandle would otherwise have been allowed from 6.46 percent to 6.25 percent.

In so treating Panhandle's accrued tax deferrals, the Commission relied solely on its opinions issued a few days earlier (March 7 and 8, 1961) in *Northern Natural Gas Co.*, 25 F.P.C. 431,[5] and *Kansas-Nebraska Gas Co.*, 25 F.P.C. 448. In *Northern Natural*, the Commission, in complete disregard of its prior rulings, had held for the first time that it could properly "divide the benefits of liberalized depreciation between the regulated company and the rate payer" with "the major portion of the benefits" going to the latter (25 F.P.C. at 439). Recognizing that failure to allow any return on these tax deferrals would probably result in "the failure of the company to use liberalized depreciation" (*Id.* at p. 438), the Commission determined as "a matter of judgment" (*Id.* at p. 439) and without taking any evidence on the question, that a return of 1.5 percent coupled with "certain material advantages" (*Id.* at p. 441), provided "a sufficient incentive to a regulated company to take advantage of" Section 167 (*Id.* at p. 439). In *Kansas-Nebraska*, the Commission reached the same conclusion with regard to accelerated amortization without further explanation. 25 F.P.C. at 451-452.

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[4] $4,116,859 under Section 167; $6,960,095 under Section 168 (R. 30).

[5] Petitions for review of this opinion were filed in the Court of Appeals for the District of Columbia Circuit. *Northern Natural Gas Co.* v. *F.P.C.*, D.C. Cir. No. 16421; *Public Service Commission of Wisconsin* v. *F.P.C.*, D.C. Cir. No. 16397. Pursuant to the terms of a settlement agreement with regard to Northern's pending rate cases, these cases were dismissed prior to decision by the court.

On appeal filed by Panhandle, a panel of the Court of Appeals, in a 2-1 decision, set aside the Commission order and remanded the case to the Commission for entry of an order allowing Panhandle to retain the full benefits of Sections 167 and 168 (App. A, pp. 1a-13a, 15a). Referring to its prior decision in *City of Detroit*, the court held (App. A, pp. 5a, 9a):

> "* * * the purpose of Congress in enacting the accelerated amortization statute was to encourage industry, including public utilities, to invest more capital in fixed assets and thereby to increase productivity and spur the national economy. If the economic advantage arising out of the accelerated amortization is to be largely passed on to the ratepayers—which is the effect of the Commission's order—the purpose of Congress will be defeated as far as public utilities are concerned.
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> * * *
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> "* * * Congress has not provided that, with respect to utilities, ratepayers are entitled to share in the temporary benefits resulting from the use of liberalized depreciation in computing income taxes. Such a provision, which would put utilities and unregulated companies in different categories, may be within the competence of Congress but neither the Commission nor this court is authorized to legislate in that fashion."

On the Commission's petition for rehearing *en banc*, the court, splitting 5-4, vacated the judgment of the panel, and this time affirmed the Commission's order. App. A, pp. 16a-46a. The court recognized that Congress intended Section 167[6] as "a means * * * to assist modernization and expansion of industrial capacity, with resulting economic growth, increased production and a higher

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[6] For reasons which were not explained, the court considered only Section 167 and completely ignored the fact that $6,960,095 of the tax accruals in question are attributable to facilities amortized by Panhandle under Section 168.

standard of living'" (App. A, p. 19a). The court also recognized that the Commission has a responsibility to effectuate this Congressional purpose in setting rates under the Natural Gas Act; however, the court ruled that the requirements of Section 167 would be satisfied if the Commission allowed only those minimum benefits "necessary to provide incentives to investment" (App. A, p. 21a). Further, the court held that the Commission's result was supported by "sound principles of rate regulation" which, according to the court, require the Commission "to permit the company no more of a return on these funds than that necessary to effectuate the congressional policy underlying the tax statute" (App. A, p. 21a). Finally, the court concluded that the Commission's finding, that a 1.5 percent return together with certain other alleged "material benefits" provided an adequate incentive, was "within [its] expert competence" and should not be disturbed (App. A, pp. 21a-22a).

Panhandle filed a timely petition for rehearing *en banc*. In addition to pointing out the substantive errors, Panhandle questioned whether at the time the *en banc* decision was issued Judge Edgerton was an "active circuit judge" within the meaning of 28 U.S.C. 46(c), *infra*, p. 19. In this regard, Panhandle pointed out that Judge Edgerton had on March 22, 1962 advised the President of his intention to retire "to take effect only when the successor you appoint is ready to be sworn in" and that the Senate had confirmed the appointment of his successor on March 15, 1963, the very day on which the court's *en banc* decision was issued. In these circumstances, Panhandle urged that Judge Edgerton's participation in the *en banc* decision was not consonant with the purpose of Section 46(c). With Judge Edgerton still participating, the court *en banc* denied Panhandle's petition on April 18, 1963.[7]

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[7] Judge Edgerton's successor took the oath of office on April 22, 1963.

REASONS FOR GRANTING THE WRIT

Both of the questions presented by this case clearly warrant review by this Court.

The issue of the propriety of including in the capitalization of a natural gas company its tax deferrals accumulated through the use of Sections 167 and 168 of the Internal Revenue Code at a 1.5 percent return involves a matter of great and continuing importance to the Commission and to the entire natural gas industry.[8] The Commission itself urged the importance of this issue in its petition for rehearing *en banc* and the court below recognized that importance by its grant of rehearing *en banc*.

In light of the prior decisions of the Commission and the court below in which a full return was consistently allowed without reduction for the reserves accumulated under Sections 167 and 168, virtually every natural-gas company has elected to use these sections. Substantial funds have been accumulated as a result of this reliance, aggregating, according to the Commission, some $280,000,000 as of the end of 1962 with respect to liberalized depreciation alone.[9] These accumulated deferrals will continue in existence for some time while they are being used to pay the increased taxes during the later years of the service life of the facilities involved. The decision below improperly sanctions the withholding of the major portion of the benefits of Sections 167 and 168 from the taxpayer companies, contrary to the Congressional intent as clearly

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[8] This question is also involved in cases pending in the Third and Fifth Circuits. *Southern Natural Gas Co.* v. *F.P.C.*, 3rd Cir. No. 14399; *El Paso Natural Gas Co.* v. *F.P.C.*, 5th Cir. No. 20180; *People of the State of California et al.* v. *F.P.C.*, 5th Cir. No. 20203.

[9] See Respondent's Petition for Rehearing *en banc* in the court below (R. 85-86).

expressed by Congress and as explicitly recognized by the Commission and the court below in the past; and it repudiates, without any justification, the assurances upon which Panhandle (and other natural gas companies) elected to use Sections 167 and 168.[10]

The Commission has now followed two entirely different positions regarding the treatment of the tax deferrals arising under Sections 167 and 168. This administrative inconsistency has caused great uncertainty, and has made it impossible for natural gas companies to know the consequences of important tax elections which they are required to make. It is submitted that a question of such importance should not be left for the Commission to decide *ad hoc* "as a matter of judgment," with no discernible standards of guidance. Unless corrected, this may be the result of the approach taken in the erroneous decision of the court below.

The question of Judge Edgerton's participation is also of importance in the administration of justice in the courts of appeals, and it bears upon the validity of the judgment below because the crucial vote thereon was cast by Judge Edgerton. This Court has characterized the proper composition of the courts of appeals in *en banc* proceedings as "an important and useful device in the administration of justice in the courts of appeals * * *." (*Western Pac. R. Corp.* v. *Western Pac. R. Co.*, 345 U.S. 247, 260, fn. 20 (1953)). And it has also recognized that Congress has in 28 U.S.C. 46(c) limited participation in *en banc* proceedings to "active circuit judges" for the purpose of enabling a majority of the court's judges " 'to control and thereby to secure uniformity and continuity in its decisions' * * * ". *United States* v. *American-Foreign S.S. Corp.*, 363 U.S. 685, 689 (1960). Judge Edgerton's par-

[10] As noted in the dissent (App. A, pp. 43a, 45a-46a), Panhandle "made clear to the Commission it would not feel justified in making the election without official assurance of full benefit therefrom."

ticipation and his casting of the deciding vote in the instant *en banc* decision, issued on the very day as his successor was confirmed, is completely at odds with this purpose.

1(a). Contrary to the court below (App. A, pp. 19a-21a), Congress clearly intended the benefits of Sections 167 and 168 solely for the taxpayer who makes the investment which Congress sought to encourage; these provisions are not for the benefit of consumers. Before reversing its position in *Northern Natural* and the instant case, the Commission had consistently so recognized. Thus, for example, in *El Paso Natural Gas Co., supra*, 22 F.P.C. 260, 266, the Commission held that "the intent of Congress was not to benefit the consumers * * *."[11] Similarly, prior to its instant decision, the court below had acknowledged (*City of Detroit* case, *supra*, 230 F. 2d 815, 822):

> "* * * [t]he intent of Congress reflected in Section 124A [now 168] is *not* to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities. * * * The funds go into a reserve account for the payment of the deferred taxes to accrue over the five year amortization period. *Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from Section 124A*" (emphasis supplied).[12]

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[11] See, also *Phillips Petroleum Co., supra*, 24 F.P.C. 537, 570 ("The accelerated amortization provisions were to benefit the taxpayers, not the consumers"); *United Fuel Gas Co., supra*, 23 F.P.C. 127, 131 ("the purpose of Section 167 * * * is not to benefit consumers directly * * *").

[12] The court below purported to distinguish *City of Detroit* as not involving the question of the return to be allowed on those funds (App. A, p. 19a, fn. 4). But, while *City of Detroit* was phrased in terms of whether the reserves should be included in the rate base, the end result is precisely the same whether phrased in terms of rate base, as in *City of Detroit*, or in terms of rate of return

It is these prior views of the Commission and the court below, rather than those now espoused by them, which accord with the legislative history of these provisions. Not only was it Congress' purpose in enacting Sections 167 and 168 to encourage all taxpayers, including regulated utilities, to make increased investments in plant and equipment, as the court below admitted (App. A, p. 19a), but Congress plainly understood that it was essential to the achievement of this purpose that the benefits of the tax deferrals resulting from the use of these provisions should be retained by the taxpayer companies. H. Rep. No. 1337, 83d Cong. 2nd Sess., p. 24; S. Rep. No. 1622, 83d Cong. 2nd Sess., p. 26; 100 Cong. Rec. 3424 (Chairman Reed of the House Ways and Means Committee), 3434 (Congressman Byrnes), 3553 (Congressman Knox).

It is significant that there is "nothing in the language or legislative history of Sections 167 and 168" to support a contention that Congress overlooked "their regulatory consequence" (App. A, p. 41a). On the contrary, "Congress made those sections general in application, with their benefits available to regulated companies as well as unregulated businesses" (App. A, p. 41a). It is beyond dispute that unregulated companies are entitled to the full benefits of these sections without sharing them with their customers, and there is no basis for a different treatment of regulated companies.

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as in the instant case. Since dollars of return are determined by multiplying rate base by rate of return, the same reduction in dollars of return can be achieved by modifying either factor. Thus, limiting Panhandle to a 1.5% return on facilities financed by deferred tax accruals accomplishes precisely the same end result in dollars of return as would be achieved by deducting 77% of these accruals from the rate base.

That *City of Detroit* required the allowance of a full return had repeatedly been recognized by the Commission (See, e.g., *Phillips Petroleum Co., supra*, 24 F.P.C. 537, 571), a recognition reiterated even in the *Northern Natural* opinion (25 F.P.C. 431, 437) on which the Commission based its ruling here.

It is also significant that Congress has been advised on several occasions of the decisions of the Commission and the court below in *City of Detroit* holding that Section 168 was intended to benefit the taxpayer companies, not the consumers. And in 1956, when it decided the *Amere* case, *supra*, the Commission noted that it was calling the decision to the attention of the Chairmen of the appropriate House and Senate committees. 15 F.P.C. at 782; see, also, *El Paso Natural Gas Co., supra*, 22 F.P.C. 260, 266-7. These decisions were again called to the attention of these committees by the Antitrust and Monopoly Subcommittee of the Senate Judiciary Committee, which after full exploration thereof with responsible Commission officials,[13] noted that "under the regulations of the Federal Power Commission, as upheld by the courts, it has been held that Congress did not intend consumers to benefit through lower rates as a result of tax amortization but rather that the inducement was intended as a benefit to the * * * company." S. Rep. No. 1380, 85th Cong. 2d Sess., p. 4; see, also, pp. 67-68, 81.

In 1957 opponents of the Commission's treatment of Sections 167 and 168 introduced two bills seeking to amend the Federal Power Act to require the Commission to pass on the tax benefits of these provisions to the rate payers. H.R. 5824, S. 2113, 85th Cong., 1st Sess. Those bills failed of passage, while Congress amended Sections 167 and 168 in other respects in 1957 and 1958, without in any way affecting the basic provisions here involved (see 71 Stat. 414, 72 Stat. 1608, 1665). The validity of the earlier holdings of the Commission and the court below was thus approved and affirmed. *United States* v. *American Trucking Ass'ns, Inc.*, 310 U.S. 534, 550 (1940); *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 115 (1939).

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[13] See Hearings on Rapid Amortization in Regulated Industries before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, 85th Cong., 1st Sess., pp. 421, 439-440, 923.

(b) Both the Commission and the court recognized that Sections 167 and 168 are "tax incentive" provisions; however, they fell into fundamental error of misconceiving the nature of the incentive which Congress intended. This appears clearly from the Commission's opinion in *Northern Natural* on which the Commission relied exclusively in the instant matter. There the Commission purported to justify its allowance of a 1.5 percent return on the ground that this would provide the company "with a sufficient incentive to continue to use liberalized depreciation. * * *" (25 F.P.C. at 439). The legislative history makes clear that Congress intended to provide not merely an incentive "to use liberalized depreciation" but more importantly, as the Commission itself conceded in its brief in the court below (p. 16), an incentive "to foster industrial growth and expansion * * *." This Congressional purpose was completely ignored by the Commission in this case.

The court below was aware of this fatal defect and attempted to cure it by reading into the Commission's opinion a finding which simply is not there. The court volunteered that the Commission's decision "implicitly" recognized that "a return of 1.5 percent provides sufficient profit incentive for the company *to continue generating these funds by investing in plant* and utilizing accelerated depreciation." (App. A; pp. 20a, 21a) (Emphasis supplied.) This is completely unfounded because the Commission did not consider or discuss the question of what rate of return would be required to give the company the incentive for "investing in plant" intended by Congress under Sections 167 and 168.

Although the court attempts to equate the two, an incentive to "invest in plant" is plainly not the same as an incentive to "continue to use accelerated depreciation." Under both Sections 167 and 168, Panhandle has the right at any time to change back to straight-line depreciation for facilities already constructed and in use; but the incentive which might be sufficient to induce the company to

refrain from reverting to straight-line depreciation would have little influence upon the decision to invest in new facilities. This misconception as to the incentive intended by Congress under Sections 167 and 168 is not a matter of mere semantics. It is one of the fundamental issues in this case. The Commission has attempted to substitute a so-called "incentive" of its own invention for that which Congress prescribed, and the court has erroneously given its approval to this result.

(c) Similarly erroneous is the court's purported application of conventional "principles of rate regulation" to the special situation presented by Sections 167 and 168 (App. A, p. 21a). The court assumes that there is an interrelationship, or perhaps even a conflict, between Sections 167 and 168 and the Natural Gas Act, whereas in fact this is not so. On the one hand, Congress intended the taxpayer company, not the consumer, to receive the benefits of Sections 167 and 168 as an incentive for plant expansion. These provisions are not "rate-reducing provisions as to regulated companies" (App. A, p. 43a). Thus, Sections 167 and 168, "unlike the Natural Gas Act itself [are] not for consumer benefit" and have "a different public policy [which] should be given effect as intended by Congress" (*City of Detroit, supra*, 230 F. 2d at 822).

On the other hand, permitting the taxpayer companies to retain the benefits of Sections 167 and 168 does *not* result in penalizing the consumers. They pay virtually the same rates as if the company had elected not to use Sections 167 and 168. As the court below stated in *City of Detroit*, 230 F. 2d at 822:

> "* * * the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. * * *"

See, also, App. A, p. 30a; *United Fuel Gas Co., supra*, 23 F.P.C. at 513. ("The customer is not injured by liberalized

depreciation; it pays a rate as though this tax incentive did not exist"). In a word, Sections 167 and 168 concern only the taxpayer companies and the United States Treasury without, in any way, involving the consumers or Commission regulation under the Natural Gas Act. Consequently, the "principles of rate regulation", invoked by the court below, plainly play no role here.

The court compounded its error by its further suggestion that "principles of rate regulation" require the Commission "to permit the company no more of a return on these funds than that necessary to effectuate the congressional policy underlying the tax statute" (App. A, p. 21a). As stated in the dissent below (App. A, p. 42a):

> "* * * This amounts to saying that Congress made a mistake in making those sections fully applicable to regulated natural gas companies * * * and that the Commission and [the] court [below] have the right to amend the sections in accord with their 'economic and regulatory philosophy'."

Patently, it is not within the province of the Commission, under the guise of "expertise" or administrative discretion to reduce the inducement fashioned by Congress. It was Congress which determined the quantum of the incentive and made it equally applicable to every segment of American industry, including the natural gas industry. If the benefit provided is to be changed, it is for Congress—not the Commission (or the court below)—to take the appropriate action.

(d) The Commission and the court erred in concluding that the requirements of the tax statute would be satisfied by a return merely sufficient to induce the taxpayer companies to use Sections 167 and 168.[14] Even assuming for

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[14] The court's characterization of this conclusion as "a matter of judgment" (App. A, p. 22a) does not operate to relieve the Commission of the duty to make "basic findings supported by evidence and ultimate findings which flow rationally from the basic findings * * *" (*Capital Transit Co.* v. *P.U.C.*, 213 F. 2d 176, 187 (D.C. Cir. 1953), *cert denied*, 348 U.S. 816 (1954)).

purposes of argument that this is the proper test, the court below still erred in affirming the Commission's conclusion that a 1.5 percent return together with "other 'material advantages'." would satisfy this requirement. Not only is there nothing in the instant record to support such a conclusion,[15] but the record contains conclusive evidence to the contrary (see R. 31-32). As the dissent below noted (App. A, pp. 45a-46a), Panhandle "made clear to the Commission it would not feel justified in making the election without official assurance of *full* benefit therefrom," and as the dissent below further commented (App. A, p. 44a) the "other 'material advantages' do not compensate Panhandle for the loss of a fair return on facilities acquired with tax deferrals." In any event, these alleged "other 'material advantages' ", and the 1.5 percent return, fall far short of providing the benefits which Congress intended the taxpayer companies should have under Sections 167 and 168 as an effective inducement for increased plant investment.

2(a). On March 22, 1962, Judge Edgerton advised the President of his retirement "to take effect only when the successor you appoint is ready to be sworn in." Pursuant to this advice, the President nominated Carl A. McGowan as Judge Edgerton's successor and the Senate confirmed this appointment on March 15, 1963 (109 Cong. Rec. 4150) (daily ed.).

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[15] The various computations referred to by the Commission in the *Northern Natural* case (25 F.P.C. at 439-441) are based on the record in that case, to which Panhandle was not a party. And even these computations do not support the Commission's result as the Commission itself admitted (25 F.P.C. at 439). While the 1.5% return was purportedly justified on the theory that the company would earn approximately the same amount if it had borrowed these funds instead of using Sections 167 and 168 (*Ibid.*), the Commission admitted that "it is probably neither fair nor realistic to assume that [the company] will *borrow* all of this money" (*Ibid.*) (Emphasis supplied). It further recognized that "it would be more fair to consider that additional moneys would be obtained without substantial change in the existing ratio between debt and equity * * *" (*Id.* at 438).

We respectfully submit that in these circumstances, Judge Edgerton was disqualified from participating and casting the deciding vote in the *en banc* decision issued herein on March 15, 1963, the very day on which his successor was confirmed, because he had then ceased to be an "active circuit judge" within the meaning and intendment of 28 U.S.C. 46(c) which provides:

> "Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in *active* service. A court in banc shall consist of all *active* judges of the circuit." (Emphasis supplied)

This Court's decision in *United States* v. *American-Foreign S.S. Corp.*, 363 U.S. 685 (1960), clearly discloses that Judge Edgerton had ceased to be a permanent active circuit judge before he cast the controlling vote in the decision below. In that case, Judge Medina of the Second Circuit participated in the original panel decision and the granting of rehearing *en banc* but retired before the issuance of the *en banc* decision. In holding that in these circumstances, Section 46(c) barred Judge Medina's participation in the *en banc* decision, this Court espoused the view of Judge Maris[16] that an essential function of *en banc* proceedings is to secure uniformity and continuity in the court's decisions for the foreseeable future (360 U.S. at 689-690):

> "'The principal utility of determination by the courts of appeals in banc is to enable the court to maintain its integrity as an institution by making it possible for a majority of its judges always to control and thereby to secure uniformity and continuity in its decisions, while enabling the court at the same time to follow the efficient and time-saving procedure of having

[16] Section 46(c) had its genesis in the proposal made in 1944 by Judge Maris as Chairman of the Judicial Conference Committee on the Revision of the Judicial Code. See *Western Pac. R. Corp.* v. *Western Pac. R. Co.*, 345 U.S. 247, 253-254 (1953).

> panels of three judges hear and decide the vast majority of cases as to which no division exists within the court.' Maris, Hearing and Rehearing Cases in Banc, 14 F.R.D. 91, at page 96 (1954)."

In the same vein, this Court further pointed out that "Congress may well have thought that it would frustrate a basic purpose of the legislation not to confine the power of *en banc* decision to the permanent active membership of a Court of Appeals" (*Id.* at 689) since "the evident policy of the statute was to provide 'that the active circuit judges shall determine the major doctrinal trends of the future for their court * * *'" (*Id.* at 690).

The thrust of this Court's holding is to remove any doubt that Judge Edgerton no longer was "an active circuit judge" within Section 46(c) at the time the instant *en banc* decision was issued. When Judge Edgerton advised the President of his intention to retire, he took himself out of "the permanent active membership of [the] Court of Appeals." The confirmation of his successor further emphasizes the fact that Judge Edgerton had ceased to be in a position to "determine the major doctrinal trends of the future for" the court below.

(b). The applicability here of *American-Foreign S.S. Corp.* is unimpaired by the fact that in that case Judge Medina's retirement became effective virtually immediately, whereas Judge Edgerton had conditioned the effective date of his retirement upon his successor's being "ready to be sworn in." Not only was this condition on the verge of fulfillment, if not fulfilled, on the date the *en banc* decision was issued, but the consequences of the condition which Judge Edgerton imposed are so inconsistent with the thrust of Section 46(c) as to require denial of its effectiveness under that section. Indeed, the practical consequences flowing are indistinguishable from those attending Judge Medina's retirement. The instant *en banc* decision no more reflects the views of the majority of "the permanent active membership" of the court below than did the *en banc* decision which this Court vacated in the *American-Foreign S.S. Corp.* case because of Judge Medina's participation.

Nor can it be validly contended that giving effect to Judge Edgerton's condition would have the merit of enabling him to break ties among his brethren and thereby avoid the need to "suspend [the court's] judicial task" (see *American-Foreign S.S. Corp.* v. *United States*, 265 F. 2d 139, 154 (2d Cir. 1959)). This would frustrate the intent of Congress, which for the extraordinary purposes of the *en banc* proceeding, carefully defined those participating to exclude retired Justices, retired circuit judges, judges of other circuits and district judges, all of whom may sit in panel proceedings by assignment. Moreover, this very argument has already been rejected by this Court in the *American-Foreign S.S. Corp.* case. As pointed out by the Government in its brief in that case (Br. for the U. S. in No. 138, Oct. T., 1959 at pp. 13-14), the court below could have carried the case through to ultimate disposition by an even number of judges or withheld its decision so as to give the new active judge an opportunity to participate. See, also R. 136.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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July 16, 1963

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

Petition to Review Order of the
Federal Power Commission

Decided September 27, 1962

Before WILBUR K. MILLER, *Chief Judge*, and BAZELON and BURGER, *Circuit Judges*.

WILBUR K. MILLER, *Chief Judge*: Panhandle Eastern Pipe Line Company, a "natural-gas company" within the meaning of the Natural Gas Act[1] and as such subject to regulation by the Federal Power Commission, petitions for review of an order entered March 20, 1961, by which the Commission restricted it to a return of 1.5 per cent on facilities acquired with tax reserves accrued under Sections 167 and 168 of the Internal Revenue Code of 1954.[2]

Under these sections a company may elect to employ, in computing its income taxes, accelerated amortization or liberalized depreciation of certain facilities instead of normal straight-line depreciation. Obviously, this treatment of depreciation results in greater annual deductions therefor during the early years of the property's anticipated

[1] 15 U.S.C. § 717a(6).

[2] 26 U.S.C. §§ 167 and 168. Section 168, providing for accelerated amortization, was originally enacted in 1950 as Section 124A. Section 167, the liberalized depreciation measure, was adopted in 1954.

useful life than does the straight-line method, and so reduces tax payments during those years. It is equally obvious that, after enhanced depreciation is taken during the early years, depreciation deductions during the later years will be correspondingly smaller, so that income tax payments will then be higher than if normal straight-line depreciation had been used during the useful life.

It is thus seen that accelerated amortization or liberalized depreciation produces only temporary tax savings: a portion of the tax payments which would be due in the early years under straight-line depreciation is merely deferred until the later years. In the meantime, however, if the taxpayer is actually accumulating a reserve for income taxes based on straight-line depreciation, it has during the early years an excess of reserve over actual current payments which it can use for plant expansion or other investment purposes until it is needed to make the larger tax payments of the later years. This is the principal benefit Congress intended to confer on the taxpaying company by enacting Sections 167 and 168.

In August, 1952, soon after the enactment of the accelerated amortization act—Section 124A (now Section 168)—Panhandle initiated a proceeding before the Commission for a declaratory order to determine whether it would be allowed to retain the tax benefits which would result if it were to adopt accelerated amortization under that section. On December 4, 1953, after expanding the proceeding into a rule-making determination in which Panhandle participated, the Commission issued its Opinion No. 264, *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 F.P.C. 369. It there announced the general rule that pipeline companies would be allowed to retain all the benefits resulting from accelerated amortization and that none of these benefits would be passed on to utility customers. In the course of its opinion, the Commission said, at page 373:

"Not infrequently, the depreciation methods allowed and recognized by a regulatory agency are not the same as those used by the utility for computing income taxes. We will recognize normal depreciation where a public utility or natural gas company has the privilege of accelerated amortization under section 124A [now 168] of the Internal Revenue Code. We will use all safeguards at our command to insure that the ratepayer [*sic*] is protected from bearing any burden greater than normal depreciation after the period of accelerated amortization has expired. . . .

". . . [I]t is clear to us that Congress, by the enactment of this law, did not intend to make gifts to the customers of the public utilities and natural gas companies which received certificates . . . ."

Against that background, Panhandle elected to use accelerated amortization for federal income tax purposes and constructed new facilities with funds thereby accumulated.

On April 15, 1954, the Commission entered an order prescribing certain rates and charges for Panhandle. With respect to the latter's use of accelerated amortization, the Commission said:[3]

". . . We have computed the tax payments which would have been required without the accelerated amortization which Panhandle is permitted, and for the purposes of the rate schedules under study have considered that Panhandle will be allowed as operating expenses such normalized taxes. This does not allow Panhandle for rate purposes more than a fair return over the long period, but does recognize the grant by Congress of certain temporary tax savings under Section 124A [168]."

[3] Opinion No. 269, Panhandle Eastern Pipe Line Co., et al., 13 F.P.C. 53, 83 (1954).

Since Section 124A (168) was not intended to reduce but only to defer tax liability, the Commission further stated:[4]

> ". . . [T]he accruals for taxes in excess of those actually paid should logically be treated by Panhandle, not as free and unrestricted income, but earmarked to provide for the future meeting of such liability."

The City of Detroit and County of Wayne, customers of Panhandle, petitioned this court for review of the order of April 15, 1954, on the ground, *inter alia*, that the Commission erred in "normalizing" income tax expense as if amortization had not been accelerated. They contended that the saving effected by the accelerated amortization should inure, partly at least, to the benefit of consumers.

We held the Commission had correctly concluded "that the intent of Congress, reflected in section 124A [168] is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities."[5] We added the following:[6]

> ". . . Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of deferred taxes to accrue after the five year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted,

[4] *Ibid.*

[5] City of Detroit v. Federal Power Comm'n, 97 U.S. App. D.C. 269, 272, 230 F. 2d 810, 822 (1955), *cert. denied* 352 U.S. 829 (1956).

[6] *Ibid.*

> it is difficult to see how Panhandle could benefit substantially from section 124A [168]. This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress."

As the opinion of this court thus indicated, the purpose of Congress in enacting the accelerated amortization statute was to encourage industry, including public utilities, to invest more capital in fixed assets and thereby to increase productivity and spur the national economy. If the economic advantage arising out of the accelerated amortization is to be largely passed on to the ratepayers —which is the effect of the Commission's order—the purpose of Congress will be defeated as far as public utilities are concerned.

It will be observed that the *City of Detroit* case dealt only with accelerated amortization under what is now Section 168. With respect to Section 167, the Commission ruled in *Amere Gas Utilities Co., et al.*, 15 F.P.C. 760, at 781 (1956), that liberalized depreciation should be accorded the same treatment as that given to accelerated amortization. Thereafter, Panhandle elected to use liberalized depreciation for federal income tax purposes and decided to build numerous facilities with funds so derived.

Through such tax deferrals, Panhandle accumulated $11,076,954,[7] which the Commission, true to its promise in

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[7] $4,116,859 under Section 167; $6,960,095 under Section 168. Section 167 is a continuing provision, whereas certification under Section 168 has terminated.

its Opinion No. 264,[8] required it to record in a special account entitled "Accumulated Deferred Taxes on Income" so it would be available to pay the larger taxes during the later years when little or no depreciation deduction for tax purposes could be taken. Thus, the ratepayers were assured that, throughout the useful life of the facilities, they would contribute no more than the income taxes based on normal straight-line depreciation.

We come now to the proceeding in which the order presently under review was entered. On September 10, 1959, several years after the status of the tax accruals had been established as outlined above, Panhandle filed with the Commission proposed increased rates which the Commission suspended and later permitted to become effective under bond. After hearings, the Commission issued an order March 20, 1961, disallowing the proposed rates. It found proper a 6.25 per cent return on transmission facilities, and said the finding was based, in part, upon the determination "that a factual statement of a pipeline company's capital should include the amounts accumulated in the restricted account for deferred taxes, and that a net return of 1.5 percent should be attributed to such amounts."[9]

This is the order we are asked to review. Panhandle and the Commission have stipulated that the question presented is as follows:

> "Was it error for the Federal Power Commission to allow a return of 1.5% on the portion of the rate base financed by funds representing the difference between the income taxes which Panhandle would have been required to pay without liberalized depreciation and accelerated amortization, as provided by Sections 167

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[8] Treatment of Federal Income Taxes as Affected by Accelerated Amortization, *supra*.

[9] 25 F.P.C. 550 (1961).

and 168 of the Internal Revenue Code of 1954, and the taxes actually paid, which funds are recorded in restricted accounts entitled 'Accumulated Deferred Income Taxes'?"

Panhandle contends it is entitled to a full return on facilities acquired with the tax deferrals, and that, by allowing a return of only 1.5 per cent thereon, the Commission has in effect withdrawn a substantial portion of those facilities from its rate base; that this has the effect of giving to the ratepayers a large part of the benefit of the tax deferral program which Congress intended to give the taxpayer. The Commission's order was based upon its Opinion No. 342, *Northern Natural Gas Co.*, 25 F.P.C. 431 (1961). In that opinion, the Commission said, at pages 437 and 439:

> ". . . [T]he statement in the above quotation from the *City of Detroit* case that to permit the company to use the funds for income-producing purposes would not result in higher rates to the consumer has on more careful consideration been disclosed to be erroneous.
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> * * * * *
>
> "In our view, *the best solution to this problem is to divide the benefits of liberalized depreciation between the regulated company and the ratepayer.* . . . [W]e believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation, and not return to the use of straight-line depreciation in the computation of its income taxes. . . ." (Emphasis added.)

In the *City of Detroit* case the question whether temporary income tax savings resulting from accelerated

amortization should be divided between the company and the ratepayers was presented, and was answered in the negative by the Commission and by this court. The Commission answered it differently in the *Northern Natural* case, and justified its action by saying that a statement in our *City of Detroit* opinion "has . . . been disclosed to be erroneous."

From this it is clear that in its *Northern Natural* opinion the Commission deliberately refused to follow this court's *City of Detroit* holding which sustained its former position. It has done the same thing in the present case. In argument here, the Commission asserts and attempts to show that the order under review is "entirely consistent with" our *City of Detroit* decision. Yet it says:

> ". . . The breadth of some of the Court's language must be assumed to have resulted from the parties' and the Court's failure fully to anticipate the issue of the present case and thus fully to appreciate the potential future ramifications of the tax normalization treatment approved in *City of Detroit*."

and adds that:

> ". . . [W]hile the decision in *City of Detroit* was sound, the opinion should be reexamined with a view to recognition of the *basically dynamic and fluid effect* of accelerated amortization and liberalized depreciation . . . (Emphasis added.)

> • • • • •

> ". . . The Court should make it clear that the law does not prohibit regulatory action which would allow ratepayers to participate in the benefit from a utility's use of accelerated amortization and liberalized depreciation for federal income tax purposes. . . ."

This could be done only by overruling the *City of Detroit* case. Our consistent practice is that one division of the

court will not overrule the recent decision of another division; only the court *en banc* can do that. So, were we disposed to do it, we could not reexamine the *City of Detroit* case. Instead of being so disposed, we adhere to the ruling of that decision. We cannot change the plain purpose of these statutory sections merely because the Commission thinks they have had a "basically dynamic and fluid effect." Congress has not provided that, with respect to utilities, ratepayers are entitled to share in the temporary benefits resulting from the use of liberalized depreciation in computing income taxes. Such a provision, which would put utilities and unregulated companies in different categories, may be within the competence of Congress, but neither the Commission nor this court is authorized to legislate in that fashion. Moreover, if it should hereafter provide that utilities must share with their ratepayers the temporary reduction of income taxes produced by liberalized depreciation during the early years of useful life, Congress probably would also provide that ratepayers should proportionately bear the higher income taxes during the later years of the anticipated life of the facilities, when the depreciation deduction for tax purposes is relatively small. This would defeat the purpose of the Commission's present order.

The order under review will be set aside, and the case will be remanded to the Commission with directions to enter an order allowing Panhandle the full benefit of liberalized depreciation and accelerated amortization.

It is so ordered.

BAZELON, *Circuit Judge*, dissenting: Ordinarily the focus of our review in rate proceedings is whether the rate fixed by the Commission allows "enough revenue not only for operating expenses but also for the capital costs of the business" and a return "sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and attract capital," *Federal Power Comm'n* v.

Hope Nat. Gas, 320 U.S. 591, 602 (1944). Panhandle does not allege that the 6.25 per cent over-all return allowed by the Commission fails to satisfy these criteria. Thus, there may be some doubt whether we should inquire into the question whether the 1.5 per cent return[1] allowed by the Commission on that portion of Panhandle's rate base representing a reserve for deferred income taxes is "just and reasonable." Natural Gas Act § 5(a), 15 U.S.C. §717c (1958). But since the majority has passed upon this issue, I will address myself to it.

The problem arises as follows. Sections 167 and 168 of the 1954 Tax Code permit taxpayers to write off depreciable property more quickly than is permitted under the "straight line" method of depreciation. If a taxpayer takes advantage of these provisions, each unit of property will give rise to a greater depreciation deduction in the earlier years of its useful life than under straight line depreciation. By contrast, in later years, the same unit of property will generate a smaller depreciation deduction than under the straight line method. For this reason, liberalized depreciation and rapid amortization are said to result in tax deferrals rather than tax savings.

For taxpayers not subject to rate regulation, the deferrals temporarily increase cash available for investment or dividends—unless competition compels the taxpayer to pass the tax benefits on to consumers in the form of price reductions.

Some regulated public utilities have been directed to reduce their rates to reflect the lower tax costs currently incurred as a result of the tax provisions.[2] But the Federal Power Commission permits companies subject to its jurisdiction to include as a current cost of service the taxes

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[1] See note 5 *infra*.

[2] See Swiren, *Accelerated Depreciation: Tax Benefits in Utility Rate Making*, 28 U. CHI. L. REV. 629, 632-33 (1961) (citing cases).

that would have been paid using the straight line method. The difference between that amount and the tax actually paid must be accounted for by establishing a "reserve for deferred taxes" to which the hypothetical tax payments are credited.[3]

These reserves represent payments by rate payers in excess of present requirements in order to defray tax liabilities which could arise in the future if capital expenditures for replacements and additions declined or if the rapid amortization and accelerated depreciation provisions of the Tax Code were repealed.[4] In a real sense, they represent funds borrowed from the United States Treasury.[5] They are not available for distribution to stockholders as dividends;[6] nor do they constitute additional capital contributions.

We sustained the Commission's treatment of these deferred tax payments in *City of Detroit* v. *Federal Power Comm'n*[7] against the claim of one of Panhandle's customers that such treatment did not result in the "lowest reasonable rates" required by § 5(a) of the Natural Gas Act. We also sustained the Commission's decision to include in

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[3] This accounting treatment is called "normalization," since it removes the impact of the tax deferrals from both tax and depreciation accounts, and thus shows what earnings would have been, had "straight line" depreciation been followed.

[4] See Swiren, *supra* note 2 at 636-40.

[5] Accord: Swiren, *supra* note 2 at 634. Thus, the 1.5 per cent figure arrived at by the Commission is not arbitrary. The Commission found that Panhandle's shareholders would have earned approximately that amount on the facilities in question had they been financed by selling bonds. Since the funds are, in effect, borrowed from the Treasury, the 1.5 percent return seems more appropriate than the "full return" required by the majority.

[6] See 18 C.F.R. Part 201, pp. 503-05 (1961).

[7] 97 U.S.App.D.C. 260, 230 F.2d 810 (1955), *cert. denied*, 352 U.S. 829 (1956).

Panhandle's rate base the funds generated by the tax deferrals and placed in the reserve for deferred taxes. The question we are called upon to decide here is whether the 1.5 per cent return the Commission has allowed on that reserve is sufficient.

Panhandle asserts that the tax statutes require the Commission to allow a return on the reserve equivalent to the weighted average cost of Panhandle's capital secured from outside sources. Neither the text nor the legislative history of the tax provisions shows that Congress considered the regulatory consequences of the provisions in question.[8] Hence a claim based on the tax statute that a 1.5 per cent return on such reserves is too small must fail. And I do not agree with the court's holding that our decision in *City of Detroit* v. *Federal Power Comm'n*, *supra*, is controlling here. There we held only that the Commission properly allowed Panhandle to include in its rate base amounts which it had deducted as depreciation in its tax return.[9] The question of what return should be allowed on reserves set up to "normalize" tax payments was not presented for decision.

In *City of Detroit* we noted that the purpose of the tax provisions was "not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities" and that unless Panhandle was permitted to normalize its depreciation for rate-making purposes, "it is difficult to see how Panhandle could benefit substantially from [the tax provision]."[10] Thus, *City of Detroit* would require reversal only if the benefits allowed Panhandle were insufficient for that purpose.

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[8] Swiren, *Accelerated Depreciation: Tax Benefits in Utility Rate Making*, 28 U.CHI.L.REV. 629, 631, 636 (1961).

[9] Depreciation is ordinarily deducted from gross property in arriving at the net property included in a rate base. See Graham & Dodd, SECURITY ANALYSIS 251 (1951).

[10] 97 U.S.App.D.C. at 272, 230 F.2d at 822.

We need not decide whether that purpose would be served solely by allowing a 1.5 per cent return on the deferred tax reserve, for there are additional considerations. Deferred tax reserves are available to reduce the Company's debt ratio and enable it to acquire plant without issuing additional securities, thereby giving existing shareholders additional earnings between rates cases.[11] And the return ultimately allowed on plant thus acquired is available to existing shareholders without dilution.[12] Considering the nature and advantages of these reserves, I have no difficulty in determining that the Commission could reasonably expect that, together with a 1.5 per cent return, these reserves would "benefit [the Company] substantially,"[13] and provide the incentive for accumulating such reserves.

I would therefore affirm the order under review.

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[11] *Northern Natural Gas Co.*, 25 F.P.C. 431, 441 (1961).

[12] *Ibid.*

[13] *City of Detroit* v. *Federal Power Comm'n*, *supra* note 7.

Filed September 27, 1962

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

On Petition to Review an Order of the Federal Power Commission.

Before: Wilbur K. Miller, Chief Judge, and Bazelon and Burger, Circuit Judges.

Judgment

This case came on to be heard on the record from the Federal Power Commission, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this court, that the order of the Federal Power Commission on review herein, is set aside, and this case is hereby remanded to the Commission with directions to enter an order allowing Panhandle Eastern Pipe Line Company the full benefit of liberalized depreciation and accelerated amortization.

Per Chief Judge Wilber K. Miller.

Dated: Sep. 27, 1962

Separate dissenting opinion by Circuit Judge Bazelon.

Filed Oct. 15, 1962

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1962

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

Before: Burger, Circuit Judge, in Chambers.

Order

It is ORDERED that on page 9 of the opinion filed herein September 27, 1962, the following be added after the majority opinion:

BURGER, *Circuit Judge, concurring:* It seems clear that *City of Detroit, supra*, is controlling and, as Judge Miller points out, we are bound by that holding. The Commission urges that our holding in *City of Detroit* "has . . . been disclosed to be erroneous" but until that is judicially established the case is controlling.

WARREN E. BURGER
Warren E. Burger
Circuit Judge

October 15, 1962

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16479

PANHANDLE EASTERN PIPE LINE CO., PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

On Petition to Review an Order
of the Federal Power Commission

On Rehearing en banc

Decided March 15, 1963

Before BAZELON, Chief Judge, and EDGERTON, WILBUR K. MILLER, FAHY, WASHINGTON, DANAHER, BASTIAN, BURGER and WRIGHT, Circuit Judges, sitting en banc.

BAZELON, *Chief Judge*: In a rate proceeding under § 4(e) of the Natural Gas Act,[1] the Federal Power Commission allowed Panhandle Eastern Pipe Line Company an over-all return of 6.25 per cent on its total rate base, reflecting a rate of return of 1.5 per cent on $11,000,000 of investment from its reserves for deferred income taxes. In this petition for review, Panhandle's only complaint relates to the rate allowed on the reserves.

These reserves are generated by Panhandle's use of § 167 of the Internal Revenue Code[2] which authorizes tax-

[1] 15 U.S.C. § 717c(e).

[2] 26 U.S.C. § 167.

payers to write off depreciable property more quickly than is permitted under the "straight-line" method of depreciation. The liberalized method provides higher depreciation deductions and therefore lower taxes during the early part of the life of a given property, and lower deductions and higher taxes in the later years of the life of the property. The total depreciation deductions available to a company over the entire life of a facility are the same using either method. The comparative advantage provided by liberalized depreciation is that it defers to the later life of a given property a portion of the taxes on income that would be payable in the early years under straight-line depreciation, and gives the company the use of such moneys in the interval. Liberalized depreciation under § 167 is thus said to result in tax deferrals rather than tax savings. *Cf. City of Detroit* v. *Federal Power Comm'n*, 97 U.S.App.D.C. 260, 230 F.2d 810 (1955); *El Paso Natural Gas Co.* v. *Federal Power Comm'n*, 281 F.2d 547, 573 (5th Cir. 1960). But see Eisner, *Depreciation under the New Tax Law*, 33 HARV. BUS. REV. No. 1, pp. 66-74.

In *City of Detroit*, we sustained the Commission's action in permitting Panhandle (1) to use the straight-line method of depreciation in fixing its rates, while using the accelerated method for computing its tax expense, and (2) to include reserves for deferred taxes in its rate base. We rejected a rate-payer's objection that such treatment did not produce the "lowest reasonable rates" required by § 5(a) of the Natural Gas Act.[3] But the question of what return, if any, should be allowed on reserve funds included in the rate base was not before us in *City of Detroit*. It is the sole question presented in this case.

Here the Commission, following its decision in *Northern Natural Gas Co.*, 25 FPC 431 (1961), "divided the benefits of liberalized depreciation between the regulated company

[3] 15 U.S.C. § 717c(a).

and the rate payer" giving the "major portion of the benefits to the rate-payer." It permitted Panhandle "only so much of [a return on funds generated by the use of liberalized depreciation] as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation." Thus, a substantially lower rate of return was attributed to those funds than to other capital.

Panhandle insists that Congress intended all the benefits of liberalized depreciation for the taxpayer and none for the rate-payer. Accordingly, it urges that the tax statute assures a "full return" on the deferred-tax reserves equivalent to the rate of return of 6.46 per cent which the Commission allowed on other investment.

In their briefs, the Commission and some of the State Commissions suggest that the regulatory treatment of tax benefits is entirely a matter of discretion and policy within the administrative competence of the agencies charged with regulating rates, and that consequently the Commission would have power to deny the company *any* return on the funds generated by liberalized depreciation and to *require* the companies to continue to utilize such depreciation. But the Commission did not follow that course. Instead, it sought to give "such effect to the purposes of the tax statute as is appropriate within the principles of regulatory law expressed in the Natural Gas Act." We therefore intimate no opinion concerning the validity of the course proposed in the briefs, and consider only the Commission's action under review.

In reviewing that action, we must first decide whether the congressional purposes underlying the tax and gas acts are effectuated by permitting a rate of return on the funds generated by the use of liberalized depreciation no higher than that required to provide the company with "a sufficient incentive to continue to use liberalized depreciation." And if they are, we must then decide whether 1.5 per cent constitutes such a rate of return.

We now briefly consider the policy underlying § 167 of the tax statute. Nothing in the language or legislative history indicates that Congress considered its regulatory consequences. Thus, to infer that the statute materially altered fundamental principles of rate regulation—which require rates to reflect actual costs of capital—it must clearly appear that Congress intended to benefit producers to the exclusion of consumers. It does not so appear: the legislative history reveals that Congress intended the statute "to have far-reaching economic effects" extending to "all segments of the American economy."[1] Liberalized depreciation was seen as a means toward a broad economic goal: it was expected to "assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living." (House and Senate Reports accompanying Internal Revenue Code of 1954, reprinted in U. S. Code Cong. & Ad. News, 83d Cong., 2d Sess. Vol. 3, 4046-48, 4655, 4835.)

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[1] Insofar as the opinion in *City of Detroit*, *supra*, indicates that the intent of Congress in the revenue act was to benefit taxpaying producers and not their consumers, we may regard it as limited to the circumstances of that case, where the petitioning consumer sought to have the amounts recovered as depreciation expense deducted entirely from the producer's rate base. We held that the Commission properly included such reserves in the rate base. The present case is distinguishable. Here the Commission seeks only to limit the rate of return on such reserves. And since the opinion in *City of Detroit* uses language broader than required for the decision on this aspect of the case, we are not constrained to read the case as deciding that in all circumstances and in the light of greater experience with the operation of § 167 the greatest possible benefit should inure to the producer and none at all permitted to the consumer. Furthermore, the additional advantages to the taxpaying producer in using accelerated depreciation urged in this case appear to be more substantial than those discussed in *City of Detroit*. See note 5, *infra*.

To set this economic spiral in motion, producers must, of course, be willing to invest in plant and incur the attendant risks. Congress permitted "acceleration in the speed of the tax-free recovery of costs [because it considered this] of critical importance in the decision of management to incur [such] risks." *Ibid.* The Commission's decision does not disturb this acceleration; it relates only to the rate of return allowed a regulated company on the reinvestment of the money thus recovered. Although Congress was not directly concerned with this rate, it may be argued that, to the extent that this rate influences the company's initial decision to invest in plant, it does touch upon the congressional purpose underlying the tax act. But even under this view, the congressional purpose could not be adversely affected unless the regulated companies were prevented from re-employing recovered funds at a sufficient profit to provide incentive to initial investment.

The Commission explicitly rested its determination on the judgment that the rate of return it allowed on the recovered funds, taken with the other "material advantages,"[5] would provide the company "with a sufficient incentive to continue to use liberalized depreciation . . . ." This implicitly recognizes that, since the recovered funds were acquired at no cost to the company, and since the

[5] The other "material advantages" which the Commission found would result from "the use of deferred taxes to supply a portion of the company's capital requirements," are as follows:

> "The substantial sums involved are readily available without resort to the market, and such additions to capital serve to reduce the company's debt ratio. The acquisition of plant by use of deferred taxes provides additional security not subject to lien on which new loans can be based, perhaps at lower interest rates than would otherwise be possible. Furthermore, deferred tax funds accumulated between rate cases and invested in plant may, during that period, increase the company's earnings. Finally, the accumulation of deferred taxes increases the company's funds available for expansion without issuing additional common stock."

risks involved in their reinvestment are minimal as compared with the risks generally encountered by non-regulated producers, a return of 1.5 per cent provides sufficient profit incentive for the company to continue generating these funds by investing in plant and utilizing accelerated depreciation.

Since there is no indication that Congress intended to bestow upon the producers *qua* producers any benefits beyond those necessary to provide incentives to investment, we conclude that, if a return of 1.5 per cent taken with the other advantages does provide such incentive, the Commission's decision would be consistent with the congressional policy underlying the tax statute.

Next we consider "the principles of regulatory law expressed in the Natural Gas Act," which impelled the Commission to allow no more of a return on these funds than that necessary to effectuate the tax act. These principles include the requirement that a public utility must operate on the most economical basis consistent with good service and sound finance. Implicit in this requirement is the rule that the rates charged must reflect the company's actual total costs, including its cost of capital. Since the capital represented by the funds generated by accelerated depreciation cost the company nothing, sound principles of rate regulation support the Commission's decisions to permit the company no more of a return on these funds than that necessary to effectuate the congressional policy underlying the tax statute. See *Cities of Lexington, et al. v. Federal Power Comm'n*, 295 F.2d 109 (4th Cir. 1961); *El Paso Natural Gas Co. v. Federal Power Comm'n*, 281 F.2d 567 (5th Cir. 1960).

The Commission, "[a]fter careful consideration of the various factors involved" decided that a specific return of 1.5 per cent on the recovered funds, coupled with the other advantages derived from the use of liberalized depreciation, provides sufficient incentive for the continued use of

liberalized depreciation. This conclusion was "largely a matter of judgment based upon such factors as [the Commission's] knowledge of the money market, and [its] estimate as to what course most regulated companies will elect to pursue in the future." Since these evaluations are within the expert competence of the Commission, we do not disturb the conclusions derived from them.

Affirmed.

WILBUR K. MILLER, *Circuit Judge*, with whom *Circuit Judges* DANAHER, BASTIAN and BURGER join, dissenting: The erroneous order now affirmed by the majority derived largely from two sources: (a) the mistaken notion that, as to industries regulated by it, the Commission has power to limit the effect of the plain mandate of Congress expressed in Sections 167 and 168,[1] and (b) the Commission's refusal,

[1] 26 U.S.C. §§ 167 and 168. Section 168, providing for accelerated amortization, was originally enacted in 1950 as Section 124A. Section 167, the liberalized depreciation measure, was adopted in 1954.

Under these sections a company may elect to employ, in computing its income taxes, accelerated amortization or liberalized depreciation of certain facilities instead of normal straight-line depreciation. Obviously, this treatment of depreciation results in greater annual deductions therefor during the early years of the property's anticipated useful life than does the straight-line method, and so reduces the tax payments during those years. It is equally obvious that, after enhanced depreciation is taken during the early years, depreciation deductions during the later years will be correspondingly smaller, so that income tax payments will then be higher than if normal straight-line depreciation had been used for income tax purposes throughout the useful life.

It is thus seen that accelerated amortization and liberalized depreciation produce only temporary tax savings: a portion of the tax payments which would be due in the early years under straight-line depreciation is merely deferred until the later years. In the meantime, however, if the taxpayer is actually accumulating a reserve for income taxes based on straight-line depreciation, it

contrary to its own precedents and in defiance of our *City of Detroit* opinion,[2] to recognize that the statutory accelerated amortization and liberalized depreciation are essentially bookkeeping entries for federal income tax purposes, in which the ratepayers have no interest. They stand apart from these transactions between the Government and the taxpaying pipeline company, and continue to pay rates based on straight-line depreciation throughout the useful life of depreciable facilities, no more and no less. Thus, to give the ratepayers the lion's share of accelerated amortization and liberalized depreciation during the earlier years of useful life without requiring them to bear a corresponding share in the disadvantages of the later years when there is no amortization and smaller depreciation, is to confer on them an unfair advantage which is directly contrary to what Congress commanded. It also unfairly takes from the pipeline company a portion of the total depreciation it is entitled to recover.

A statement of the case's background will place these points in proper perspective, and will serve to introduce my subsequent discussion of the majority opinion's infirmities. Such a statement follows.

In August, 1952, soon after the enactment of the accelerated amortization statute—Section 124A (now Section 168)—Panhandle initiated a proceeding before the Commission for a declaratory order as to whether it would be

has during the early years an excess of reserve over actual current payments which it can use for plant expansion or other investment purposes until it is needed to make the larger tax payments of the later years. This is the principal benefit Congress intended to confer on the taxpaying company by enacting Sections 167 and 168. It is plain, I think, that the payer of rates calculated on straight-line depreciation during the whole useful life is not affected by, and therefore has no interest in, these statutory provisions.

[2] City of Detroit v. Federal Power Comm'n, 97 U.S. App. D.C. 260, 230 F. (2d) 810 (1955), *cert. denied* 352 U.S. 829 (1956).

allowed to retain the tax benefits which would result if it were to adopt accelerated amortization under that section. On December 4, 1953, after expanding the proceeding into a rule-making determination in which Panhandle participated, the Commission issued its Opinion No. 264, *Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, 12 F.P.C. 369. It there announced the general rule that pipeline companies would be allowed to retain all the benefits resulting from accelerated amortization and that none of these benefits would be passed on to utility customers.

In the course of its opinion, the Commission said, at pages 370, 371:

> "... The former section 124 of the Code having been made applicable to certified emergency facilities constructed by utility companies, as well as others, and the new section 124A [now 168] having the same jurisdictional language and the same basic objectives, the new section, of course, is applicable to electric public utilities and natural gas companies and we have no alternative but to construe it so. In fact, no one who argued before us disputed this point.
>
> "Under the accelerated amortization provision of section 124A, any taxpayer who has received a certificate of necessity issued by the proper defense agency for the construction of an emergency facility may elect to take a deduction from gross income over a period of 60 months for the amortization of a specified percentage of the cost of such emergency facilities in lieu of equal annual deductions for exhaustion, wear and tear, and obsolescence during the estimated life of the facilities. Congress sought by this accelerated amortization provision to encourage the construction with private capital of those facilities which were deemed of sufficient value to the national defense to warrant the issuance of a certificate of necessity.

"Thus, the recipient of a certificate of necessity obtains substantial deductions against the net income for income tax purposes during each of the first 5 years, and much smaller deductions therefrom during the remainder of the normal amortization period. If the income tax rates remained the same during the entire life of the facilities, the same amount of taxes ultimately would be paid under either accelerated or normal amortization. By the enactment of this law, Congress did not forgive the payment of any income taxes; it merely allowed payment of some of them to be deferred. This has the precise effect of a grant by our Government to a certificate holder of an interest-free loan.

"Although all parties concede that certificates of necessity issued to electric public utilities and natural gas companies are perfectly valid and lawful, it has been strenuously argued that this Commission should nullify them by reducing the rates of such companies during the 5-year period of rapid amortization and thereby pass on to the customers of such companies the money which otherwise would inure to these companies by reason of their being permitted to defer payment of a portion of their income taxes.

"The answer to this contention is that Congress obviously did not intend to make cash donations to the particular persons who happen to be, during the 5-year period of accelerated amortization, the customers of the particular utilities which have received the certificates of necessity. Such a result would be inconsistent with the effort of Congress to aid our national defense."

The Commission added, at page 373:

"Not infrequently the depreciation methods allowed and recognized by a regulatory agency are not the same as those used by the utility for computing income

> taxes. We will recognize normal depreciation where a public utility or natural gas company has the privilege of accelerated amortization under section 124A [now 168] of the Internal Revenue Code. We will use all safeguards at our command to insure that the ratepayer [*sic*] is protected from bearing any burden greater than normal depreciation after the period of accelerated amortization has expired. . . .
>
> ". . . [I]t is clear to us that Congress, by the enactment of this law, did not intend to make gifts to the customers of the public utilities and natural gas companies which received certificates . . ."

Against that background, Panhandle elected to use accelerated amortization for federal income tax purposes and constructed new facilities with funds thereby accumulated.

On April 15, 1954, the Commission entered an order prescribing certain rates and charges for Panhandle. With respect to the latter's use of accelerated amortization, the Commission said:[3]

> ". . . We have computed the tax payments which would have been required without the accelerated amortization which Panhandle is permitted, and for the purposes of the rate schedules under study have considered that Panhandle will be allowed as operating expenses such normalized taxes. This does not allow Panhandle for rate purposes more than a fair return over the long period, but does recognize the grant by Congress of certain temporary tax savings under Section 124A [168]."

Since Section 124A (168) was not intended to reduce but only to defer tax liability, the Commission further stated:[4]

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[3] Opinion No. 269, Panhandle Eastern Pipe Line Co., et al., 13 FPC 53, 83 (1954).

[4] *Ibid.*

> "... [T]he accruals for taxes in excess of those actually paid should logically be treated by Panhandle, not as free and unrestricted income, but earmarked to provide for the future meeting of such liability."

The City of Detroit and County of Wayne, customers of Panhandle, petitioned this court for review of the order of April 15, 1954, on the ground, *inter alia*, that the Commission erred in "normalizing" income tax expense as if amortization had not been accelerated. They contended that the saving effected by the accelerated amortization should inure, partly at least, to the benefit of consumers.

We held the Commission had correctly concluded "that the intent of Congress reflected in section 124A [168] is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities."[5] We added the following:[6]

> "... Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of deferred taxes to accrue after the five year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from section 124A [168]. This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be

[5] City of Detroit v. Federal Power Comm'n, 97 U.S. App. D.C. at 272, 230 F. (2d) at 822.

[6] *Ibid.*

given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress."

As the opinion of this court thus recognized, the purpose of Congress in enacting the accelerated amortization statute was to encourage industry, including natural gas companies, to invest more capital in fixed assets and thereby to increase productivity and spur the national economy. If the economic advantage arising out of the accelerated amortization is to be largely passed on to the ratepayers —which is the effect of the Commission's order—the purpose of Congress will be defeated as far as public utilities are concerned.

It will be observed that the *City of Detroit* case dealt only with accelerated amortization under what is now Section 168. With respect to Section 167, the Commission ruled in *Amere Gas Utilities Co., et al.*, 15 F.P.C. 760, at 781 (1956), that liberalized depreciation should be accorded the same treatment as that given to accelerated amortization. It said, at pages 781-782:

"We are in agreement with the decision of the presiding examiner. We can find no legal difference between the problem now before us and that which was presented to us by section 124A (now section 168) of the Internal Revenue Code, pertaining to 5-year amortization of defense facilities pursuant to a certificate issued by a defense agency of the United States. Therefore, what was said in our opinion No. 264 in docket No. R-126, and in our opinion No. 269 in Panhandle Eastern Pipe Line Co., docket No. G-1116, *et al.*, and what was said by the United States Court of Appeals for the District of Columbia Circuit in *City of Detroit*

v. *Federal Power Commission*, on December 15, 1955 (230 F. 2d 810), in which the Commission's treatment of accelerated depreciation [*sic*] in the Panhandle case was fully approved, *is completely controlling in this matter.*

"Admittedly, section 167 of the Internal Revenue Code contains no specific mandate to create a reserve account for the deferred taxes. Nevertheless, we know of no way to effectuate the clear and obvious Congressional intent, except by doing so, just as we did in our two prior opinions above mentioned. The argument that the sums in the reserve account will rightfully belong to the rate payers, or that the rate payers will bear any burden they do not now bear, by reason of the creation of the reserve, is wholly erroneous, as was lucidly explained by the United States Court of Appeals for the District of Columbia, above cited:

> "'. . . The funds go into a reserve account for the the payment of the deferred taxes to accrue after the 5-year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from section 124A [now 168]. This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress. . . .'

"It is clear that the charging of greater depreciation during the early life of property and the charging of less during the later life operates to create a deferral of income taxes. The fact that there may be continu-

ing additions to plant; year by year, with the result that there will be a balance in the reserve account at all times in the foreseeable future, does not prove that there is no tax deferral. On the contrary, it proves that there is a continuing tax deferral so long as additional facilities are being installed. This is precisely what Congress intended.

* * * * *

"*We cannot strike down an act of Congress if we think it unwise, or unnecessary to a particular industry, and enforce it only if it is in accord with our economic and regulatory philosophy.* It is undisputed that section 167 of the Internal Revenue Code does apply, and was intended to apply to regulated natural gas companies, such as the petitioners." (Emphasis added.)

Thereafter, Panhandle elected to use liberalized depreciation for federal income tax purposes and decided to build numerous facilities with funds so derived. Through the two methods of tax deferral, Panhandle accumulated $11,076,954,[7] which the Commission, true to its promise in its Opinion No. 264[8] required it to record in a special account entitled "Accumulated Deferred Taxes on Income," so it would be available to pay the larger taxes during the later years when little or no depreciation deduction for tax purposes could be taken. Thus, the ratepayers were assured that, throughout the useful life of the facilities, they would contribute no more than the income taxes based on normal straight-line depreciation.

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[7] $4,116,859 under Section 167; $6,960,095 under Section 168. Section 167 is a continuing provision, whereas certification under Section 168 has terminated.

[8] Treatment of Federal Income Taxes as Affected by Accelerated Amortization, *supra*.

On September 28, 1960, while the present proceeding was pending before it, the Commission again decided, in *Phillips Petroleum Co.*, 24 F.P.C. 537, that the benefits resulting from the use of accelerated amortization were intended for and should be retained by the taxpayer and not passed on to its customers. There it rejected its staff's proposal to artificially treat the accrued taxes as though they were a part of the company's capitalization and allow a return thereon at less than the full over-all rate. The Commission said, at page 570:

> "There was no dispute about these figures, but the staff contended that Phillips' actual debt ratio and actual cost of debt should be adjusted to reflect as an interest-free loan an item of deferred Federal income tax liability in the amount of $19,162,355, arising from the accelerated amortization provisions of Section 168 of the Internal Revenue Code. This would decrease Phillips' cost of debt to 2.76 percent. The examiner refused to make this adjustment, and we agree. *The accelerated amortization provisions were to benefit the taxpayer, not the consumers.* They represent an advantage bestowed by Congress to encourage the construction of emergency facilities, and *we are not authorized to take away this advantage. City of Detroit* v. *F.P.C.*, [97 U.S. App. D. C. 260, 272] 230 F. 2d 810, 822 (CADC), *certiorari* denied, 352 U.S. 829. . . . (Emphasis added.)"

On March 7, 1961, however, the Commission's decision in *Northern Natural Gas Co.*, 25 F.P.C. 431, reversed its former position, which we had approved, and refused to follow the *City of Detroit case*. It said, at page 437:

> "The *Panhandle* (City of Detroit) case was considered by us shortly after the enactment of Section 168. At that time, neither we nor the courts were fully aware of all of the consequences which would result if

> moneys in the deferred tax accounts were considered as belonging solely to the company. Thus, the statement in the above quotation from the *City of Detroit* case that to permit the company to use the funds for income-producing purposes would not result in higher rates to the consumer has on more careful consideration [by the Commission] been disclosed to be erroneous."

The *City of Detroit* case was decided by the Commission on December 4, 1953, so it was not considered "shortly after" the enactment of Section 168, which was in 1950; and our opinion in the *City of Detroit* case was handed down in 1955. The Commission took the same position in its *Phillips Petroleum* decision on September 28, 1960. It appears, therefore, that after eight years of experience, the Commission must have been "fully aware of all of the consequences which would result if moneys in the deferred tax accounts were considered as belonging solely to the company," when it wrote its *Phillips Petroleum* opinion on September 28, 1960. Yet, less than six months thereafter, the Commission wrote the *Northern Natural* opinion reversing the position it had consistently taken from December, 1953, to late September, 1960; and the majority now approve their change of heart "in the light of greater experience with the operation of § 167."[9]

As the Commission's initial ruling in December, 1953, was followed by it several times and as late as September 28, 1960, after eight years of experience with the depreciation statutes, clearly the Commission's departure from it

[9] The majority speak only of Section 167, the liberalized depreciation provision, enacted in 1954. Section 168, dealing with accelerated amortization, was enacted in 1950. The principles governing the application of the two sections to regulated companies is admittedly the same. Both sections are involved here because Panhandle's tax reserves come from both sources. See footnote 7.

on March 7, 1961, was not due to greater experience with their operation. It was merely an abrupt change of mind. Moreover, this court has had no experience with this problem since the *City of Detroit* case, so I conclude the majority are acting on the erroneous impression that its change of view was justified by the Commission's fanciful "greater experience."

After saying in the above quotation that our *City of Detroit* opinion was erroneous, the Commission's *Northern Natural* decision continued thus, at page 439:

> "In our view, *the best solution to this problem is to divide the benefits of liberalized depreciation between the regulated company and the ratepayer.* In dividing these benefits between the ratepayer and the company, we are guided by the principle that it is our duty to protect the consumer, and adopt ratemaking principles which will assure the lowest possible rates. Accordingly, we believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation, and not return to the use of straight-line depreciation in the computation of its income taxes. . . . ." (Emphasis added.)[10]

Chairman Kuykendall of the Commission dissented from the paragraph just quoted from the *Northern Natural* decision. After reproducing it, he said, at page 446:

> "It is our duty to apply the law (that is section 167 of the Internal Revenue Code), and not our discretion,

[10] On March 8, 1961, one day after its *Northern Natural* decision, which dealt only with liberalized depreciation, the Commission in *Kansas-Nebraska Natural Gas Co.*, 25 F.P.C. 448, reached the same conclusion with respect to accelerated amortization.

to the facts before us. We have only the legislative powers which Congress has given us, and have no power to amend section 167, distributing as we see fit the advantages given to the taxpayer by this statute.

"We should, as the language of the Court of Appeals in the *City of Detroit* case, *supra*, quoted by the majority, clearly states, allow the taxpayer the full advantage of the tax deferral, but without any disadvantage to the ratepayer. The fact that the court did not mention, and may not, in fact, have considered the possible tax deduction arising by virtue of payment of interest on borrowed money does not alter the principle involved.

"My colleagues seem to assume that the amounts accumulated through the deferral of taxes would otherwise be obtained through borrowing, or that, in any event such sums should be treated as the equivalent of debt capital. In my opinion, this is error. Such funds actually are as much or more akin to equity than to debt capital. We recognized this fact in our Order No. 203 amending our uniform system of accounts, 19 FPC 826, where we considered the possibility of setting up the reserve account as earmarked surplus. Our prohibition against payment of dividends from these funds would seem to presuppose that such sums are included in surplus."

After distinguishing the *El Paso* case,[11] relied on by the majority of the Commission, by pointing out that the problem there was whether liberalized depreciation constitutes a tax saving or a tax deferral, Chairman Kuykendall concluded by saying, at page 447:

"The views, I have expressed herein are, I believe, consistent with section 167 and its legislative history,

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[11] El Paso Natural Gas Co. v. Federal Power Comm'n, 281 F. (2d) 567 (5th Cir. 1960); *cert. denied*, 366 U.S. 912 (1961).

with the only two court decisions which are controlling (*City of Detroit* and *El Paso, supra*), and are fair to the ratepayer; yet they do not constitute a usurpation of the constitutional power of Congress."

In the *El Paso* case the Fifth Circuit discussed the treatment given by the Commission to the tax "saving" or deferral resulting from the use by the taxpayer of the declining balance method of depreciation of new equipment and said, at pages 573-574:

> ". . . In practical effect this works a tax deferral rather than a tax savings. If the company were charged for rate making purposes with such 'savings' during the year in which the depreciable assets were acquired, and the rate resulting from such treatment of the taxes was thereafter used for later years, as is here the case, it is clear that the company would be paying higher taxes in subsequent years than in the test year, *but would not be entitled to an adjustment in rates to cover the increase.* Therefore, we approve the Commission's treatment of the 'saving' resulting from using the declining balance method of depreciation for tax purposes but computing its taxes for rate making purposes on the straight line method of depreciation, placing such 'savings' in a special reserve to be used to equalize tax payments in later years. These amounts can never represent added return to the company because of the restriction as to their use." (Emphasis added.)

The only restriction as to the use of the tax deferrals is that they may not be disbursed by way of dividend. They may be invested in facilities which become a part of the rate base just as any other equipment. When the Fifth Circuit said, "These amounts [tax deferrals] can never represent added return to the company [because they may not be paid out as dividends]," it was of course not saying

the company could not earn a fair return on the facilities in which "these amounts [the tax deferrals]" are invested. For, if that were not permitted, a regulated company, forbidden by the Commission to distribute tax deferrals as dividends, could obtain no benefit whatever from Sections 167 and 168, and the Congressional intention to give it the sole benefit would be completely frustrated. That intention is proportionately defeated when, as here, a part of the benefit is taken away from the regulated company and given to its customers.

I come now to the proceeding in which the order presently under review was entered. On September 10, 1959, Panhandle filed with the Commission proposed increased rates including the usual rate of return upon the facilities acquired with tax accruals. As outlined above, this treatment of such accruals had been established for several years and was reaffirmed by the Commission on September 28, 1960, while Panhandle's proposal was pending. After hearings, the Commission abandoned the position previously taken in several cases and issued an order March 20, 1961, disallowing the proposed rates. It found proper a 6.25 per cent return on transmission facilities and said the finding was based, in part, upon its determination "that a factual statement of a pipeline company's capital should include the amounts accumulated in the restricted account for deferred taxes, and that a net return of 1.5 percent should be attributed to such amounts."[12]

This was, of course, a division of the benefits of accelerated amortization and liberalized depreciation between the regulated company and its customers, which the Commission had said in the *Northern Natural* case is the "best solution." In the *City of Detroit* case, however, the question whether the benefits resulting from accelerated amortization should be divided between the company and the

[12] 25 F.P.C. 550 (1961).

ratepayers was presented, and was answered in the negative by the Commission and by this court.

From this it is clear that in answering the question differently in its *Northern Natural* opinion, the Commission deliberately refused to follow this court's *City of Detroit* holding which sustained its former position. It has done the same thing in the present case. In argument here, the Commission asserts and attempts to show that the order under review is "entirely consistent with" our *City of Detroit* decision. Yet it says:

> ". . . The breadth of some of the Court's language must be assumed to have resulted from the parties' and the Court's failure fully to anticipate the issue of the present case and thus fully to appreciate the potential future ramifications of the tax normalization treatment approved in *City of Detroit*."

and adds that:

> ". . . [W]hile the decision in *City of Detroit* was sound, the opinion should be reexamined with a view to recognition of the *basically dynamic and fluid effect* of accelerated amortization and liberalized depreciation. . . . . (Emphasis added.)
>
> . . . . . .
>
> ". . . The Court should make it clear that the law does not prohibit regulatory action which would allow ratepayers to participate in the benefit from a utility's use of accelerated amortization and liberalized depreciation for federal income tax purposes. . . ."

The majority opinion now declares the law to be as contended for by the Commission in the paragraph last quoted. I suggest this cannot be done without expressly overruling the *City of Detroit* case, which the majority have not done. Instead, they seek to distinguish it by saying,

"... But the question of what return, if any, should be allowed on reserve funds included in the rate base was not before us in *City of Detroit*. It is the sole question presented in this case."

This is not an accurate statement of the tax deferral question presented in the *City of Detroit* case and in this case. In the former, the question was whether the benefits resulting from accelerated amortization should be divided between the pipeline company and its customers. As I have pointed out—and I repeat the quotation for emphasis—we answered the question in the negative by saying, 97 U.S. App. D.C. at 272, 230 F. (2d) at 822:

"... [T]he Commission ... concluded, we think correctly, that the intent of Congress reflected in section 124A [168] is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities. Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of the deferred taxes to accrue after the five year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from section 124A. This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress."

The question in this case is not, as the majority states, "what return, if any, should be allowed on reserve funds included in the rate base." It is, rather, whether the Commission was correct in dividing the benefit resulting from accelerated amortization and liberalized depreciation between Panhandle and its customers in the face of our *City of Detroit* opinion. There can be no question that the Commission did exactly that. In the first place, it is obvious that the allowance of a return of 1.5 percent on facilities acquired with tax deferrals amounts to dividing the benefit between Panhandle and its customers. In the second place, the Commission said in its *Northern Natural* decision that it had decided "to divide the benefits of liberalized depreciation between the regulated company and the ratepayer"; as the order under review was based on the Commission's *Northern Natural* case, it is of course true that the restrictive return of 1.5 per cent was fixed in pursuance of the Commission's determination to divide the benefit between Panhandle and its customers.

This truth cannot be escaped by saying the question was merely "what return, if any, should be allowed on reserve funds included in the rate base." By allowing a return of only 1.5 per cent on facilities acquired with tax deferrals, the Commission has in effect withdrawn a substantial portion of those facilities from Panhandle's rate base, and has given to the ratepayer a large part of the benefit of the tax deferral program which Congress intended to give to the taxpayer. As I have said, it is obvious that 1.5 per cent is not the full return which would have been allowed if the Commission had not decided to divide the benefit between Panhandle and the ratepayers.

The majority opinion, in saying the "sole question" in this case is "what return, if any, should be allowed on reserve funds included in the rate base," rejects what both the Commission and Panhandle agreed was the issue. In a pre-hearing stipulation the parties agreed this question was presented:

"Was it error for the Federal Power Commission to allow a return of 1.5% on the portion of the rate base financed by funds representing the difference between the income taxes which Panhandle would have been required to pay without liberalized depreciation and accelerated amortization, as provided by Sections 167 and 168 of the Internal Revenue Code of 1954, and the taxes actually paid, which funds are recorded in restricted accounts entitled 'Accumulated Deferred Income Taxes'?"

That is to say, was it error for the Commission to allow a return of 1.5 per cent on the portion of the rate base financed by tax deferrals and thus divide the benefit resulting from Sections 167 and 168 between Panhandle and its customers? That is the true question here, and I suggest it was answered by our *City of Detroit* opinion.

In another attempt to distinguish this case from that one, the majority say in their footnote 4:

"... We held [in the *City of Detroit* case] that the Commission properly included such reserves in the rate base. The present case is distinguishable. Here the Commission seeks only to limit the rate of return of such reserves. ..."

The statement from the *City of Detroit* opinion, which I have already quoted twice, was much more than a decision that the Commission properly included the tax reserves in the rate base. We affirmed the Commission's conclusion that the intent of Congress in Section 124A [168] was not to benefit consumers, as was explicitly recognized in the *City of Detroit* case, but to encourage all taxpayers, both regulated and unregulated, to modernize and expand their facilities. That conclusion was the basis of the Commission's rejection of Detroit's contention that the benefit should go to Panhandle's customers or be divided with them—a rejection which we affirmed in unequivocal lan-

guage because we recognized the Congressional intention to give all the benefit to the taxpaying company. But now the majority necessarily limit the plain language of the *City of Detroit* opinion in order to limit the operation of the statutes. In footnote 4, the majority not only attempt to distinguish that case, as I have said; they also brand its holding as dictum by saying it "uses language broader than required for the decision on this aspect of the case." Because of this branding—or misbranding—the majority say:

> ". . . [W]e are not constrained to read the case as deciding that in all circumstances and in the light of greater experience with the operation of § 167 the greatest possible benefit should inure to the producer [*sic*] and none at all permitted to the consumer. . . ."

They also say:

> ". . . Nothing in the language or legislative history [of Section 167] indicates that Congress considered its regulatory consequences. . . ."

By the same token, nothing in the language or legislative history of Sections 167 and 168 indicates that Congress did *not* consider their regulatory consequences. Congress made those sections general in application, with their benefits available to regulated companies as well as unregulated businesses; this is beyond dispute. Indeed, it was admitted by the Commission in the *Amere* case, 15 F.P.C. at 782:

> ". . . It is undisputed that section 167 of the Internal Revenue Code does apply, and was intended to apply to regulated natural gas companies, such as the petitioners."

The majority err, I think, and go beyond their province when they say the sections, though general in language, do not apply literally to regulated companies because their

language and legislative history do not show Congress considered their "regulatory consequences."

Before the Commission changed its position, it said in its *Amere* opinion, *supra* at 782:

> ". . . The argument that the sums in the reserve account will rightfully belong to the rate payers, or that the rate payers will bear any burden they do not now bear, by reasons of the creation of the reserve, is wholly erroneous. . . ."

Then it added this significant language:

> "We cannot strike down an act of Congress if we think it unwise, or unnecessary to a particular industry, and enforce it only if it is in accord with our economic and regulatory philosophy. . . ."

Yet in the *Northern Natural* case, and in the order in the present case, the Commission substantially amended Sections 167 and 168 by denying their full benefit to regulated companies. Its brief in this case says the *City of Detroit* case "should be reexamined with a view to recognition of the basically dynamic and fluid effect of accelerated amortization and liberalized depreciation." And the majority opinion supports that position by saying that Congress did not consider the regulatory consequences of Sections 167 and 168. This amounts to saying that Congress made a mistake in making those sections fully applicable to regulated natural gas companies—as it clearly and admittedly did—and that the Commission and this court have the right to amend the sections in accord with their "economic and regulatory philosophy." I cannot agree to either of these propositions.

The majority cannot escape the plain and simple fact that their action actually reduces the rates to the customers, because it gives them the benefit of the tax deferrals in the early years without requiring them to bear a correspond-

ing burden in the later years. So, Sections 167 and 168 are transformed into rate-reducing provisions as to regulated companies, although the unregulated companies enjoy the full benefit conferred by them. In this way, the Congressional enactments are amended by the majority, and the *City of Detroit* case is overridden, although not expressly overruled. It is sheer sophistry to pretend that the court is not overruling the *City of Detroit* case.

Congress intended in these sections, as the majority admit, to "assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living." It sought to accomplish that by offering to the taxpaying company accelerated amortization and liberalized depreciation. But the Commission and the majority of this court are saying that, with respect to regulated companies, this objective may be attained by offering to them only a small part of the advantages of accelerated amortization and liberalized depreciation—only as much as they think will encourage regulated companies to modernize and expand capacity.

My point here is that the Commission and the majority of this court do not have authority to decide that; although Congress offered unequivocally a definite benefit to encourage taxpayers to modernize and expand their facilities, the same result may be achieved by offering only a part—indeed, a small part—of the designated benefit to regulated companies. After all, it is for Panhandle, and not for the Commission and this court, to decide whether to take advantage of Sections 167 and 168. Panhandle had the right to say, as it did, that it would not elect to compute its income taxes under those sections unless it could retain the benefit accruing therefrom. But now the majority are holding that 1.5 per cent return on the facilities acquired by reliance on the Commission's assurances is enough to cause Panhandle to make the election. To me, this is patently beyond the power of the Commission and the court, and contrary to the clear language of the statutes.

The majority further say:

> "... The Commission's decision does not disturb this acceleration; it relates only to the rate of return allowed a regulated company on the reinvestment of the money thus recovered. ..."

In other words, they are saying to Panhandle, "You may still use the accelerated depreciation sections, but you may not derive therefrom the benefit Congress intended to confer thereby." This is worse than consoling a widow, when the dividends upon which she is dependent are passed, by saying to her, "After all, you still have your stocks." The widow's dividends may be resumed, but Panhandle can never get more than a fraction of the benefit of the statutes.

In its footnote 5, the majority speak of "other material advantages" which the Commission thought Panhandle will enjoy from being forced to share the benefits of the statutes with its customers. These "other material advantages" do not compensate Panhandle for the loss of a fair return on facilities acquired with tax deferrals.

In addition to what precedes, I suggest that the Commission's action in its *Northern Natural* case and in this case exceeded its authority. Its determination in an earlier Panhandle case, pursuant to a rule it had previously announced, that Section 168 confers benefits on the regulated companies and not on their customers, as a consequence of which it could not divide the benefits between them, was affirmed by our *City of Detroit* case. The present case involves the same parties, the same sort of facilities, and the same issues. It would seem that our prior decision should control. But the Commission, having thereafter decided it best "to divide the benefits of liberalized depreciation between the regulated company and the ratepayer," for the second time rejected our *City of Detroit* case as erroneous, and gave a major portion of the benefits to Panhandle's customers.

A similar reversal of a prior administrative determination which had been judicially approved was forbidden by the Eighth Circuit in *National Labor Relations Bd.* v. *Brown & Root*.[13] In an initial proceeding, the Labor Board treated two corporations as separate employers, and in the ensuing review the Eighth Circuit's decision was based upon its conclusion that the two companies were not a single employer. Despite this, the Board, in a second proceeding, held that the two corporations were a single employer. But the Eighth Circuit held that the question whether they were one employer or two employers was necessarily involved in the prior proceeding in which both the Board and the court treated them as two; that therefore the Board was precluded from holding in the later proceeding that they constituted a single employer. The court quoted the general rule on the conclusiveness of judgments which was thus stated in *Henderson* v. *United States Radiator Corp.*:[14]

> "... Any right, fact or matter in issue and directly adjudicated, or necessarily involved in the determination of an action before a competent court in which a judgment or decree has been rendered upon the merits, is conclusively settled by the judgment therein and cannot again be litigated between the same parties and their privies, whether the claim, demand, purpose or subject-matter of the two suits is the same or not."

As has been shown, Panhandle sought, obtained and relied upon the Commission's determination *in a rule-making proceeding* that it would be permitted to retain the benefits of Sections 167 and 168, before electing to adopt the accelerated amortization and liberalized depreciation authorized therein. It made clear to the Commission it would not feel justified in making the elections without official assur-

[13] 203 F. (2d) 139, 146 (1953).

[14] 78 F. (2d) 674, 675 (10th Cir. 1935).

ance of full benefit therefrom. For the Commission, in any circumstances, to repudiate its assurances to Panhandle seems at least inequitable; to do it by presuming to overrule a decision of this court, is, I think, unconscionable. Why the majority aid and abet the Commission's act while asserting they are not repudiating the *City of Detroit* case is difficult to fathom.

For these reasons, it seems clear to me that the order under review is erroneous and should be reversed. Therefore, I dissent.

(Filed March 15, 1963)

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE CO., *Petitioner*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

On Petition to Review an Order of the Federal Power Commission.

Before: Bazelon, Chief Judge, and Edgerton, Wilbur K. Miller, Fahy, Washington, Danaher, Bastian, Burger and Wright, Circuit Judges, sitting en banc.

Judgment

This case came on to be reheard before the court en banc on the record from the Federal Power Commission, and was reargued by counsel.

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this court en banc that the order of the Federal Power Commission on review herein is affirmed.

Per Chief Judge BAZELON.

Dated: March 15, 1963

Separate dissenting opinion by Circuit Judge Wilbur K. Miller, with whom Circuit Judges Danaher, Bastian and Burger join.

(Filed April 18, 1963)

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 16,479

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

Before: Bazelon, Chief Judge, Edgerton, Wilbur K. Miller, Fahy, Washington, Danaher, Bastian, Burger and Wright, Circuit Judges, in Chambers.

Order

On consideration of petitioner's petition for rehearing en banc, it is

ORDERED by the court en banc that the petition is hereby denied.

PER CURIAM.

Dated: April 18, 1963

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman; Frederick Stueck, Arthur Kline and Paul A. Sweeney.

Docket No. G-19780

PANHANDLE EASTERN PIPE LINE COMPANY

Order Determining Rate of Return, Disallowing Proposed Increased Rates, Directing Payment of Refunds, and Permitting Substitution of Lower Interim Rates

(Issued March 20, 1961)

On September 10, 1959, Panhandle Eastern Pipe Line Company filed proposed rates, reflecting an increase of $8,653,700 in its effective rates. These increased rates were suspended, by order issued October 23, 1959, until March 26, 1960, when they were permitted to become effective subject to refund. Hearings were held at various times from January to August, 1960. By order issued herein on September 1, 1960, the Commission limited the issues in this phase of the proceeding to rate of return and related income taxes and omitted the intermediate decision. Oral argument was heard on November 18, 1960. Since rates reflecting further increases, filed by Panhandle in Docket No. RP60-8, were permitted to become effective July 1, 1960, this proceeding concerns Panhandle's rates during the period from March 26 to July 1, 1960.

Since Panhandle's costs of long-term debt and preferred stock are not in dispute, the calculation of the over-all rate of return to be applied to Panhandle's net investment rate base requires only the determination of the appropriate return to be attributed to Panhandle's accumulated deferred taxes and to its equity capital. In Opinion No. 342, *Northern Natural Gas Co.*, FPC , Docket No.

G-19040, March 7, 1961, it was determined that a factual statement of a pipeline company's capital should include the amounts accumulated in the restricted account for deferred taxes, and that a net return of 1.5 percent should be attributed to such amounts. The principles applied in the *Northern* case are equally applicable to Panhandle in the present case. See also, Opinion No. 343, *Kansas-Nebraska Natural Gas Co.*, ... FPC .... Docket No. G-12391, March 8, 1961.

Extensive evidence of the past earnings experience and market position of Panhandle and comparable enterprises was presented as a guide to the determination of the return on equity presently required to enable Panhandle to attract sufficient equity capital. This data, which includes earnings-price ratios and return on book value of equity, indicates that Panhandle has been and continues to be one of the strongest of the major pipelines. Panhandle's stock has steadily advanced in price, and its recent earnings per share have been such as to allow the company to pay out only 54 percent of net earnings and yet maintain a dividend rate as high as most of the other pipelines. Although a substantial portion of its retained earnings are subject to possible refunds in pending rate cases, Panhandle's financial record has generally been favorable and it demonstrates the continuing strength of the company's business position.

In recent cases, in which similar evidence of market conditions and the financial experience of the individual pipeline companies was considered, we have allowed rates of return on equity of 10.12,[1] 10.18,[2] 10.5,[3] and 10.8 percent[4]

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[1] *Tennessee Gas Transmission Co.*, ... FPC ...., Docket No. G-19983, August 9, 1960.

[2] *Southern Natural Gas Co.*, 24 FPC 26, Docket No. G-20509, July 8, 1960.

[3] *Northern Natural Gas Co., supra.*

[4] *Kansas-Nebraska Natural Gas Co., supra.*

These figures reflect in part our estimate of the particular needs of the individual company, and at the same time they represent our judgment as to the general level of earnings required to enable the pipeline industry to attract equity capital in the contemporary market. Thus, the 11.76 percent return on equity claimed by Panhandle herein appears to us to be unnecessarily high at the present time. Upon consideration of the whole record, and particularly the factors mentioned above, we conclude that a return of 10.47 percent on Panhandle's equity will maintain Panhandle's financial integrity and will be sufficient to attract the new capital needed for expansion.

Based on the foregoing determinations, the fair and reasonable over-all rate of return for Panhandle is 6.25 percent, calculated as follows, based on Panhandle's capitalization as of May 31, 1960:

	Amount	Ratio		Cost	Return
Long-term debt	$140,878,000	52.37	x	3.55	1.86
Preferred stock	9,377,700	3.49	x	3.99	.14
Accumulated deferred taxes on income	11,076,954	4.12	x	1.50	.06
Common equity	107,672,125	40.02	x	10.47	4.19
	$269,004,779	Over-all return:			6.25

The over-all rate of return so determined is applicable to Panhandle's transmission properties. Questions with regard to Panhandle's own production will be decided in the later phase of this proceeding. Panhandle's proposed increased rates filed herein should be disallowed, and Panhandle permitted to file substitute rates reflecting a 6.25 percent rate of return. Panhandle should be required to make immediate refunds, with interest, of the increased rates collected from March 26 to July 1, 1960, to the extent that such rates exceed the substitute rates based on a 6.25 percent rate of return.

The Commission finds:

(1) The fair, and just and reasonable rate of return to be allowed Panhandle is 6.25 percent; subject, however, to final disposition in the next phase of this proceeding of the remaining issues herein, and to such further order as may be justified in light of the disposition of such remaining issues.

(2) The proposed increased rates filed by Panhandle herein are excessive and should be disallowed.

(3) Panhandle should be permitted to file herein substitute lower rates satisfactory to the Commission, based on the 6.25 percent rate of return herein found to be proper for the purpose of this interim order, such substitute lower rates to become effective as of March 26, 1960, upon acceptance by the Commission, subject to refund in accordance with the Commission's order of March 25, 1960, and the undertaking heretofore filed by Panhandle in accordance with the terms of that order.

(4) Panhandle should be required to make prompt refunds with interest at 7 percent, in accordance with the Commission's order of March 25, 1960, and the undertaking heretofore filed by Panhandle, of all amounts collected by it from its jurisdictional customers subject to refund under its proposed increased rates; provided, however, that if Panhandle files substitute lower rates as herein provided, the amount of such refunds should be the excess of the amounts so collected over what it would have collected on the basis of the substitute lower rates so filed and found to be satisfactory by the Commission. A plan for making such refunds should be submitted for approval of the Commission.

The Commission orders:

(A) The proposed increased rates filed in this proceeding by Panhandle are hereby disallowed.

(B) Panhandle may, within 45 days of the date of this order file in lieu thereof appropriate substitute tariff sheets to its FPC Gas Tariffs containing lower rates satisfactory to the Commission, based on the 6.25 percent rate of return on transmission facilities herein found to be proper for the purpose of this interim order. Panhandle shall accompany its substitute filing with supporting cost of service and allocation data, to be computed and presented in the same form and manner as contained in its exhibits heretofore offered by it in this proceeding, revised only to reflect a 6.25 percent rate of return and Federal income taxes associated therewith. Panhandle shall further furnish with its filing a statement setting forth the method of computation of such substitute rates and showing the derivation thereof. Panhandle shall also accompany its substitute tariff sheets and supporting data with a certificate showing service of copies thereof on all purchasers under the rate schedules involved, interveners in this proceeding, and interested state commissions. Comments by such parties shall be submitted to the Commission within ten days after service by Panhandle as required herein.

(C) Upon acceptance of such filing of substitute rates as satisfactory to the Commission, the rates, charges and classifications set forth in Panhandle's substitute tariff sheets shall become effective as of March 26, 1960, subject to refund, in accordance with the Commission's order of March 25, 1960, and the undertaking heretofore filed by Panhandle in compliance with the terms of that order, and subject to further orders of the Commission in this proceeding.

(D) Panhandle shall, within 45 days of the date of this order, file with the Commission its plan for promptly refunding to its jurisdictional customers the amounts which, by finding paragraph (4) of this order, the Commission has found should be refunded. Panhandle shall

accompany its plan for refunds with a statement setting forth the computation of the refunds and interest, and the derivation thereof. Panhandle shall also accompany its plan for refunds and supporting statement with a certificate showing service of copies thereof on all purchasers under the rate schedules involved, interveners in this proceeding, and interested state commissions. Comments by such parties shall be submitted to the Commission within ten days after service by Panhandle as required herein. Upon approval by the Commission of said plan of refunding Panhandle shall make the refunds as so approved within 30 days thereafter, and shall report to the Commission within said 30 days the amounts so refunded to each jurisdictional customer.

(E) This order is without prejudice to further hearings in this proceeding on the issues not herein decided and to such further order or orders as the Commission may issue in the disposition of this proceeding.

By the Commission.

Chairman Kuykendall concurs but adheres to his views on liberalized depreciation as expressed in his dissenting opinion accompanying Opinion No. 342 issued in *Northern Natural Gas Company, et al.*, Docket Nos. G-19040, *et al.*

J. H. GUTRIDE
Joseph H. Gutride,
Secretary.

APPENDIX C

Internal Revenue Code of 1954

Act of Aug. 16, 1954, c. 736, as amended, 68A Stat. 51, 52, 26 U.S.C., §§ 167 and 168

Section 167

(a) General rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(b) Use of certain methods and rates.—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

(1) the straight line method,

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) Limitations on use of certain methods and rates.—Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—

(1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1953, or

(2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

* * * * *

Section 168

(a) General rule.—Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (d)), based on a period of 60 months. Such amortization deduction shall be an amount, with respect to each month of such period within the taxable year, equal to the adjusted basis of the facility at the end of such month divided by the number of months (including the month for which the deduction is computed) remaining in the period. Such adjusted basis at the end of the month shall be computed without regard to the amortization deduction for such month. The amortization deduction above provided with respect to any month shall, except to the extent provided in subsection (f), be in lieu of the depreciation deduction with respect to such facility for such month provided by section 167.

The 60-month period shall begin as to any emergency facility, at the election of the taxpayer, with the month following the month in which the facility was completed or acquired, or with the succeeding taxable year.

(b) Election of amortization.—The election of the taxpayer to take the amortization deduction and to begin the 60-month period with the month following the month in which the facility was completed or acquired, or with the taxable year succeeding the taxable year in which such facility was completed or acquired, shall be made by filing with the Secretary or his delegate, in such manner, in such form, and within such time, as the Secretary or his delegate may by regulations prescribe, a statement of such election.

(d) Definitions.—

(1) Emergency facility.—For purposes of this section, the term "emergency facility" means any facility, land, building, machinery, or equipment, or any part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1949, and with respect of which a certificate under subsection (e) has been made. In no event shall an amortization deduction be allowed in respect to any emergency facility for any taxable year unless a certificate in respect thereof under this paragraph shall have been made before the filing of the taxpayer's return for such taxable year.

(2) Emergency period.—For purposes of this section, the term "emergency period" means the period beginning January 1, 1950, and ending on the date on which the President proclaims that the utilization of a substantial portion of the emergency facilities with respect to which certifications under subsection (e) have been made is no longer required in the interest of national defense.

(e) Determination of adjusted basis of emergency facility.—In determining, for purposes of subsection (a) or (g), the adjusted basis of an emergency facility—

(1) Certifications on or before August 22, 1957.—In the case of a certificate made on or before August 22, 1957, there shall be included only so much of the amount of the adjusted basis of such facility (computed without regard to this section) as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1949, as the certifying authority, designated by the President by Executive Order, has certified as necessary in the interest of national defense during the emergency period, and only such portion of such amount as such authority has certified as attributable to defense purposes. Such certification shall be under such regulations as may be prescribed from time to time by such certifying authority with the approval of the President. An application for a certificate must be filed at such time and in such manner as may be prescribed by such certifying authority under such regulations, but in no event shall such certificate have any effect unless an application therefor is filed before March 24, 1961, or before the expiration of 6 months after the beginning of such construction, reconstruction, erection, or installation or the date of such acquisition, whichever is later.

* * * * *

Amended Aug. 26, 1957, Pub. L. 85—165, § 4, 71 Stat. 414; Sept. 2, 1958, Pub. L. 85—866, Title I, § 9(a), (b), 72 Stat. 1608.

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AUG 7 1963
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 277

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

On Petition For Writ of Certiorari to the United States Court of Appeals For the District of Columbia Circuit

BRIEF FOR INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, AMICUS CURIAE, IN SUPPORT OF PETITION

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August 7, 1963.

Press of Byron S. Adams, Washington, D. C.

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BRIEF FOR INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, AMICUS CURIAE, IN SUPPORT OF PETITION

This brief, *amicus curiae*, is filed with the consent of the parties.

INTEREST OF AMICUS CURIAE

Independent Natural Gas Association of America (INGAA) is a trade association which includes among its members most of the major pipeline companies engaged in the transportation and sale of natural gas

in interstate commerce subject to the jurisdiction of the Federal Power Commission (Commission) under the Natural Gas Act. For many years INGAA has appeared in rule-making, rate and certificate proceedings before the Commission involving issues affecting the general interests of the natural gas industry and participated before this Court and the various courts of appeals in cases arising out of Commission orders. In the instant case, INGAA has participated as *amicus curiae* at each stage of the proceedings in the court below.

The substantive question here presented concerns the proper return to be allowed on jurisdictional facilities financed by deferred income taxes accumulated by natural gas pipeline companies as a result of their use of Section 167 (liberalized depreciation) and 168 (accelerated amortization) of the Internal Revenue Code. Almost all of INGAA's pipeline company members have used one or both of these sections to defer payment of a portion of their federal income taxes. In the decision below, the Court of Appeals has approved the Commission's action of including the deferred tax accruals in the statement of Panhandle's capital and attributing to such sums a return of 1.5 percent. This has the practical effect of permitting Panhandle to earn only 1.5 percent on a portion of its rate base. If allowed to stand, this decision will result in substantial losses of revenue to the pipeline members of INGAA which, together with their affiliates, account for over 90 percent of the $320,000,000 of deferred taxes accumulated to the end of 1962 by the natural gas pipeline companies regulated by the Commission. Thus, *amicus* plainly has an immediate and significant interest in the issues presented.

REASONS FOR GRANTING THE WRIT

To minimize repetition, INGAA adopts Panhandle's petition which, it believes, fully demonstrates the need for review of the decision below by this Court. INGAA wishes only to supplement and amplify this showing by highlighting the following considerations.

I

This Case Will Affect Important Interests of the Natural Gas Industry and Must Be Speedily Resolved to Avoid Unjustified Injuries To Regulated Companies and a Multiplicity of Suits.

The question of the proper rate treatment by the Commission of deferred income tax accruals generated by the use of Sections 167 and 168 of the Internal Revenue Code requires a definitive resolution by this Court. There can be no doubt that the question is of general importance. This has already been recognized explicitly by the Commission in its petition for rehearing *en banc* and implicitly by the court below by its grant of rehearing *en banc*.

The *en banc* decision below, which in our view is plainly erroneous, was rendered by a sharply divided court, with a vigorous dissent joined in by four judges. This decision set aside the contrary ruling by the original panel. It represents a reversal of a position long held both by the Commission and the court below. As shown by the cases cited in Panhandle's petition (at pp. 5-6), for over seven years prior to its opinion issued in *Northern Natural Gas Co.* on March 7, 1961 (25 F.P.C. 431), on which its ruling herein is based, the Commission consistently held that Congress intended the full benefits of Sections 167 and 168 for the taxpayer pipeline companies. Similarly, a number of years ago the court below in *City of Detroit* v. *Federal*

Power Commission, 230 F. 2d 810 (D.C. Cir. 1955) *cert.* denied, 352 U.S. 829 (1956), had ruled with regard to Section 168 there involved (230 F. 2d at 822):

> "Though thus earmarked [in the reserve account], the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from section [168]. This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress." * * *"

It was against the background of these earlier holdings that the natural gas pipeline companies elected to use Sections 167 and 168 and invested millions of dollars of deferred income tax[1] accruals in new plant facilities, as intended by Congress. However, in its decision in *Northern Natural* the Commission departed from its prior orders and practices and ruled for the first time—in the teeth of explicit recognition of its inconsistency with *City of Detroit* (see 25 F.P.C. at 437)—that natural gas pipeline companies must pass on the bulk of the benefits of Sections 167 and 168 to their customers.

The decision to invest deferred tax funds is entirely up to the taxpayer company, and the sums of money involved are substantial. The use of Section 167 by natural gas pipeline companies generated $40,000,000 of deferred income taxes in 1962 alone.

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[1] Section 168 has not been available since 1957. As a consequence the accumulated deferred income taxes attributable to this source are now declining each year. However, at the end of 1961 natural gas pipeline companies still had more than $70,000,000 of deferred income taxes arising from use of Section 168 which had been available for corporate purposes prior to the time when the Commission changed its position. See Federal Power Commission, Statistics of Natural Gas Companies, 1961, Table 14.

The affirmance by the court below of this change by the Commission in its position will, if not reversed, not only reduce the earnings which the natural gas pipeline industry expected on the basis of the pre-1961 decisions of the Commission and of the court below to be permitted to earn on jurisdictional facilities financed in the past by deferred tax accruals, but also deter pipeline companies from investing additional large amounts of deferred taxes in new jurisdictional plant. An authoritative ruling by this Court is required to remove uncertainty, and to enable the companies to make informed decisions with regard to the investment of additional deferred tax funds.

Finally, review by this Court is needed to put this problem to rest in the cases pending in other circuits. See *Southern Natural Gas Co.* v. *Federal Power Commission*, Third Circuit Case No. 14399,[2] arising out of Opinion No. 379, issued February 18, 1963, and *El Paso Natural Gas Co.* v. *Federal Power Commission*, Fifth Circuit Case No. 20180, arising from Opinion No. 366, issued October 19, 1962. These cases involve the question here presented inasmuch as the Commission included accumulated deferred taxes in the capitalization of each company and attributed to the deferred taxes a "cost" of 1.5 percent. El Paso specifically argues that its deferred taxes are not invested in jurisdictional plant.

[2] This case is being held in abeyance pending final determination of the instant case.

II

The Commission and Court Below Have Plainly Acted Contrary to the Intent of Congress In Enacting Sections 167 and 168 of the Internal Revenue Code.

It is clear that Congress intended these Sections as a stimulus to business investment as a matter of national policy. The Committee reports and the House debates are replete with expressions of this purpose. To limit examination, for brevity, to liberalized depreciation, the Reports of the House and Senate committees considering Section 167 state:

> "More liberal depreciation allowances are anticipated to have far-reaching economic effects. The incentives resulting from the changes are well timed to help maintain the present high level of investment in plant and equipment. The acceleration in the speed of the tax-free recovery of cost is of critical importance in the decision of management to incur risk. The faster tax writeoff would increase available working capital and materially aid growing businesses in the financing of their expansion. For all segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living."[3]

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[3] Report of the Committee on Ways and Means, House of Representatives, to accompany H.R. 8300, a bill to revise the internal revenue laws, H. Rep. No. 1337, 83rd Cong., 2d Sess., p. 24 (1954); Report of the Committee on Finance, United States Senate, S. Rep. No. 1622, 83rd Cong., 2d Sess., p. 26 (1954). See also, the annual address of the President to Congress, 100 Cong. Rec. 571, January 21, 1954; Statement of the Under Secretary of the Treasury at Hearings before the Senate Committee on Finance, 83rd Cong., 2d Sess. 104 (1954).

It is equally clear from both the terms of the statutory provisions and from their legislative histories, that the deferred tax legislation was intended to and does apply equally to all types of new tangible depreciable assets, and to be available to all taxpayers.[4] Congress has repeatedly been advised of the use of these deferred tax provisions by natural gas pipelines and other regulated companies and of the Commission's determination that these tax provisions were for the benefit of the taxpaying pipeline company.[5] While it also has been urged to amend the statute to eliminate this result, Congress has not done so.[6] Even though it has amended both Section 167 and Section 168, it has not changed the law in any way to indicate that either the Court's decision or the Commission's opinions, orders and rulings *prior* to the *Northern Natural* case in 1961 had misinterpreted the Congressional intent.

Thus, Congress clearly intended to provide funds and incentives to stimulate investment by regulated industries in jurisdictional plant. By reversing its position and, in practical effect, imposing a 1.5 percent return limitation on jurisdictional plant financed by deferred taxes, the Commission has undertaken to do

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[4] See, for example, H. Rep. No. 1337, 83rd Cong., 2d Sess., pp. 23, 24 (1954); S. Rep. No. 1622, p. 25 (1954); 100 Cong. Rec. 8997, 8998, June 28, 1954.

[5] See *Amere Gas Utilities Co.*, 15 F.P.C. 781, 782 (1956); *El Paso Natural Gas Co.*, 22 F.P.C. 260, 266-267 (1959); Annual Report of the Federal Power Commission to Congress for 1956 (pp. 75-76), and for 1957 (p. 75). See also Rapid Amortization in Regulated Industries, S. Rep. No. 1380, 85th Cong., 2d Sess., 81 (1958).

[6] See Technical Amendments Act of 1958, Title I, §§ 9, 89(b), 72 Stat. 1608, 1665 and Pub. L. 85-165, § 4, 71 Stat. 414 (1957).

what Congress declined to do. It has ruled in effect that the deferred tax legislation intended to place the taxpayer who invests deferred tax accruals in interstate natural gas pipeline facilities in an inferior category. This ruling, which takes away a substantial part of the benefits granted by the tax legislation, directly contradicts the Congressional purpose of stimulating investment in *all* productive facilities.

By contrast, the allowance of a full return on plant financed by deferred tax accruals, properly sought here by Panhandle, permits Sections 167 and 168 to stimulate effectively investment in new jurisdictional plant. Unlike the Natural Gas Act itself, Sections 167 and 168 are not for consumer benefit. They have a different public policy and should be given effect as intended by Congress.[7] However, it is important to note that the Commission can carry out this intent of Congress by permitting Panhandle to earn a full return without, at the same time, penalizing the gas consumers.[8]

Finally, the Commission's limitation of the rate of return on plant financed by deferred taxes is not only inconsistent with the Congressional intent to stimulate investment in all productive facilities, but it also vir-

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[7] *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810, 822 (1955), *cert.* denied, 352 U.S. 829 (1956). See also, *El Paso Natural Gas Co.*, 22 F.P.C. 260, 266 (1955), *aff'd.* as to this issue, 281 F. 2d 567 (5th Cir. 1960), *cert.* denied *sub nom.*, *California* v. *Federal Power Commission*, 366 U.S. 912 (1961); *Phillips Petroleum Co.*, 24 F.P.C. 537, 570 (1960), *aff'd sub nom. State of Wisconsin* v. *Federal Power Commission*, 303 F. 2d 380 (D.C. Cir. 1961), *aff'd.* 373 U.S. 294 (1963), and S. Rep. No. 1380, 85th Cong., 2d Sess. 4, 67-68 (1958).

[8] See Petition for Writ of Certiorari, p. 16.

tually negates the intention of Congress to recoup the current tax revenue loss to the government caused by the deferral of taxes. This is clear, since Section 167 was designed to "broaden the tax base"[9] by financing new plant which would produce additional taxable income. The report of the Committee on Ways and Means of the House of Representatives states, in this regard:

> "If there were no stimulus to investment and all eligible taxpayers adopted the new formula, the loss in the fiscal year 1955 would be about $375 million. In the second and immediately subsequent years there would be greater losses if the effect on investment were ignored but it is highly likely that by that time the stimulus which the new formula brings will have produced a volume of additional investment and taxable income which will result in there being no net revenue loss under this provision."[10]

But if the Commission is allowed to limit the rate of return on jurisdictional plant financed by the deferred tax accruals of the natural gas pipeline companies to only 1.5 percent, it will frustrate this purpose of Congress by reducing pipeline taxable earnings, thus denying the Treasury substantial corporate tax revenues which would serve to offset current tax revenue losses arising from use of liberalized depreciation.

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[9] Statement by Congressman Reed, Chairman of the House Ways and Means Committee, during debates on the proposed legislation. 100 Cong. Rec. 3421, March 17, 1954.

[10] H. Rep. No. 1337, 83rd Cong., 2d Sess., p. 25.

III

A Return of 1.5 Percent Will Deter Investment of Deferred Taxes In New Pipeline Plant, Contrary to the Internal Revenue Code.

The court below and the Commission both failed to recognize that the Congressional intent in Sections 167 and 168 embraced a dual incentive. It would not effectuate the Congressional purpose if taxpayers were to use Sections 167 and 168 merely as a device for deferring the payment of income taxes. Congress also intended that the funds generated by the use of these Sections should be used for investment in new plant facilities. When this second incentive is recognized, it becomes apparent that the holding below falls far short of effectuating the Congressional intent.

There is no evidence of record in this case to support a finding that 1.5 percent is sufficient to attract the investment of deferred tax accruals in jurisdictional natural gas pipeline facilities. Quite the contrary, Panhandle "made clear to the Commission that it would not feel justified in making the elections without official assurance of full benefit therefrom."[11] It would be pure fiction, we submit, to assume that a return of 1.5 percent would have provided sufficient incentive to attract the investment of the millions of dollars of deferred tax accruals in jurisdictional facilities prior to 1961 when that limitation on return was first imposed by the Commission. Until that time the industry had every reason to believe that the pipeline companies would be allowed a far better return on such investments.[12]

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[11] Quotation from the dissent in the court below. See Appendix A to Petition for Writ of Certiorari, pp. 45a-46a.

[12] See discussion at pages 3-4 above.

It is clear that natural gas pipeline companies are not compelled, either by the Internal Revenue Code or the Natural Gas Act, to invest in jurisdictional facilities. Thus, under the Internal Revenue Code, Congress left to each taxpayer the decision how to use deferred tax accruals, and the Natural Gas Act explicitly leaves pipeline expansion to the initiative of the pipeline companies.[13] Section 7(a) specifically provides that the "Commission shall have no authority to compel enlargement of transportation facilities".[14]

The deferred tax accruals are the pipeline company's funds, subject to later payment of the deferred tax liability. As it invests such funds at its own risk,[15] the company has a duty to its stockholders to weigh the alternative investment opportunities prudently, to balance investment in new jurisdictional facilities against other income producing possibilities. Consequently, since such investment cannot be compelled, deferred tax accruals must be attracted to investment in new interstate natural gas pipeline facilities. To assure this result, a return "commensurate with returns on investments in other enterprises having corresponding risks" must be allowed on facilities financed with such funds. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). A return of 1.5 percent has not been shown to and indeed does not meet this standard.

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[13] See *Central West Utility Co.* v. *Federal Power Commission*, 247 F. 2d 306 (3d Cir. 1957); *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 204 F. 2d 675 (3d Cir. 1953).

[14] 52 Stat. 824 (1938), 15 U.S.C. § 717f(a).

[15] These are facts which the Commission itself recognizes. See Brief for the Commission in the court below, p. 10.

IV

The Commission May Not Lawfully Ordain An Identical Rate of Return For Very Different Pipeline Companies.

Even if it be assumed *arguendo* that the Commission could properly allow less than a full return on jurisdictional plant financed by deferred tax accruals, the affirmance of the Commission's order by the court below would nevertheless be erroneous. The Commission applied to Panhandle the same 1.5 percent return on deferred tax accruals that it applied to Northern Natural Gas Company (25 F.P.C. 431 (1961)) and Kansas-Nebraska Natural Gas Company (25 F.P.C. 448 (1961)) on the ground that the "principles applied in the *Northern* case are equally applicable to Panhandle in the present case" (25 F.P.C. at 550).

There is no indication that, in arriving at this conclusion, the Commission examined all relevant facts and circumstances of each of these three quite different companies. Certainly there is no evidence in the record of the *Panhandle* case to support such a comparison.

In these circumstances, the Commission's action is patently in error. The factors involved in a proper determination of the rate of return allowed for a particular natural gas pipeline company are varied and complex. Each case stands independently of all others and is to be decided on the record made in that case. It is well established that rate of return cannot be determined by *a priori* judgment. "A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally. * * * [N]o proper rate can be established for all

cases." *Bluefield Water Works & Improvement Co.* v. *Public Service Commission*, 262 U.S. 679, 693 (1923).

The Natural Gas Act contains only the conventional standards of rate-making. There is nothing novel in its provisions. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 616 (1944). Under such standards, the Commission may not lawfully preordain the return to be allowed natural gas pipeline companies, as it has attempted to do here. Such a procedure forecloses the Commission from the exercise of that fair and enlightened judgment, having regard for all relevant facts, which it must employ in each rate proceeding under the Natural Gas Act.

CONCLUSION

We respectfully submit that this Court should review this decision of the Court of Appeals. It sanctions a drastic departure from the Congressional purpose in enacting the liberalized depreciation and accelerated amortization provisions of the Internal Revenue Code, and the regulatory provisions of the Natural Gas Act. The issue involved is of substantial importance to the entire natural gas industry.

The petition for writ of certiorari should be granted.

Respectfully submitted,

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August 7, 1963

CERTIFICATE OF SERVICE

I, John T. Miller Jr., attorney for Independent Natural Gas Association of America and a member of the Bar of the Supreme Court of the United States, do hereby certify that I have served upon the following named attorneys a copy of the foregoing brief *amicus curiae* in support of petition for writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit by depositing true and correct copies thereof in the United States Mail, first class postage prepaid, on August 7, 1963, addressed as follows:

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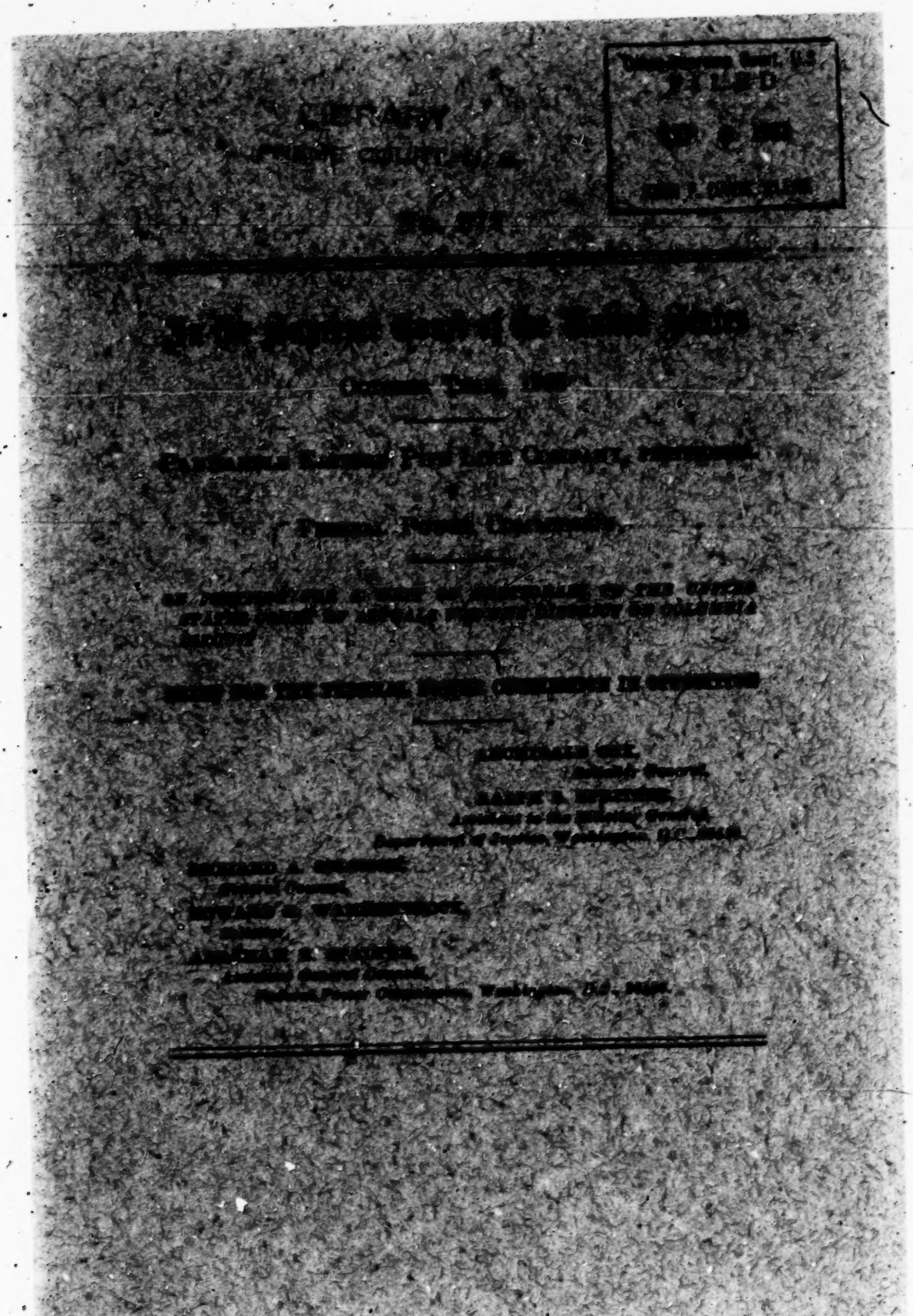

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 277

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinions of the Court of Appeals for the District of Columbia Circuit (Pet. App. A, 16a–46a) are reported at 316 F. 2d 659. The opinion of the Federal Power Commission (Pet. App. B, 1b–6b) is reported at 25 F.P.C. 550. The Commission's opinion in *Northern Natural Gas Company* (Opinion No. 342, relevant portions reprinted, Appendix, *infra*, pp. 19–38) on which its present order was based, is reported at 25 F.P.C. 431, 433–441, 445–448.

JURISDICTION

The judgment of the court of appeals was entered on March 15, 1963. A timely petition for rehearing

en banc, filed by petitioner, was denied on April 18, 1963. The petition for a writ of certiorari was filed on July 16, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Was it error for the Federal Power Commission to allow a return of 1.5 percent on the portion of the rate base financed by funds representing the difference between the income taxes which Panhandle would have been required to pay without the use of liberalized depreciation and accelerated amortization, as permitted by Sections 167 and 168 of the Internal Revenue Code of 1954, and the taxes actually paid.

2. When a circuit judge advised the President of his intention to retire "to take effect only when [his successor] is ready to be sworn in," and thereafter, without any objection by the parties, sat as a member of the court *en banc*, was he disqualified to participate in the court's decision rendered more than a week before his successor's commission was signed by the President.

STATEMENT

The Federal Power Commission order under review establishes a rate of return of 6.25% on Panhandle Eastern Pipe Line Company's total rate base for purposes of determining just and reasonable rates under Section 4(e) of the Natural Gas Act (June 21, 1938, c. 556, 52 Stat. 821–833, as amended 15 U.S.C. 717–717w). Reflected in that rate of return is an allowance of 1.5% on $11,076,954 previously accumulated

out of revenues and maintained in a special reserve account entitled "Accumulated Deferred Taxes on Income" (Pet. App. 3b).[1]

This $11 million represents the accumulated difference between the "normalized" amounts of federal income taxes which the Commission allows as an operating expense in fixing Panhandle's rates (the amount Panhandle would have paid if it had computed those taxes on the basis of conventional, straight-line depreciation) and the lower amounts actually paid by the use of liberalized depreciation (as authorized by Section 167 of the Internal Revenue Code) and accelerated amortization (pursuant to Section 168 of the Code).[1a]

The methods of liberalized depreciation authorized under Section 167 have the effect of allowing larger depreciation expenses during the early years of life of a depreciable asset than in the later years. Thus, other factors remaining constant, during the early years of an asset's life liberalized depreciation results in lower federal income taxes than does straight-line depreciation, under which the depreciation expense is the same for each year of the asset's life. By the same token, during the later years of an asset's life liberalized depreciation results in lower depreciation

[1] While the Commission has not designated the balance sheet accounts technically as "reserves", in this brief, for convenience, we shall sometimes refer to them as reserves, since the technical distinction is not relevant to the present question.

[1a] $4,116,859 under Section 167; $6,960,095 under Section 168. Section 167 is a continuing provision, whereas Section 168 was a temporary measure, with no certifications permitted after 1959 (26 U.S.C. 168(f), as added by Act of August 26, 1957, 71 Stat. 415).

charges (and thus higher taxes) than does straight-line depreciation.[2]

Use of accelerated amortization has a similar but more pronounced effect. Under Section 168, to the extent that assets have been certified as emergency facilities, they may be fully depreciated for federal income tax purposes over a period of five years. This high rate of depreciation during the first five years makes for lower income taxes during that period. Thereafter, however, depreciation on the facilities in question having been "spent", taxes are higher than they would be on a straight-line depreciation basis.

Pursuant to established practices permitted by the Commission (*Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, affirmed in relevant part, *sub nom. City of Detroit* v. *Federal Power Commission*, 97 App. D.C. 260, 230 F. 2d 810, certiorari denied, 352 U.S. 829; *El Paso Natural Gas Co.*, 22 F.P.C. 260, affirmed, in relevant part, 281 F. 2d 567 (C.A. 5), certiorari denied *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912; *United Fuel Gas Co.*, 23 F.P.C. 512, affirmed *sub nom. Cities of Lexington* v. *Federal Power Commission*, 295 F. 2d 109 (C.A. 4)), Panhandle has been including within its operating expenses (for rate-making purposes) the amount of federal income taxes which it would have paid if it had computed such taxes on the basis of straight-

[2] This analysis applies to the effect of liberalized depreciation as to an individual asset. The company's overall depreciation allowance in any year will depend on the weighted average age of its depreciable assets, since below-straight-line depreciation on old-vintage assets will tend to be counterbalanced by above-straight-line depreciation on newly-acquired assets.

line depreciation. As prescribed by the Commission's accounting regulations (Orders Nos. 171, 171A and 203, 13 F.P.C. 968 and 1051, 19 F.P.C. 826, amending Uniform System of Accounts for Class A and Class B Natural Gas Companies, 18 CFR Part 201, Accounts Nos. 281, 282, 410, 411), the excess of this amount over the taxes actually paid has been placed in reserve accounts denominated "Accumulated Deferred Income Taxes".[3] Until such time, if ever, as they may be needed to pay income taxes higher than those computed on the basis of straight-line depreciation, the funds reflected in these accounts may not be paid out in the form of dividends[4] but constitute capital which the company can use in its operations.

Panhandle contends that the Commission erred in considering the source of these funds in determining a fair rate of return, which, it argues, should have been set at 6.46%, the weighted average cost[5] of its

[3] Account 281, balance sheet account for "Accumulated deferred income taxes—Accelerated amortization"; Account 282 (similarly for liberalized depreciation); the annual provisions for deferred taxes are classified in Account 410, "Provision for deferred income taxes"; Account 411, "Income taxes deferred in prior years—credit."

[4] In this brief, for convenience, we shall refer to this Commission—approved method of treating liberalized depreciation and accelerated amortization as "normalization." We shall use the term "flow-through" to refer to the alternative practice of including within federal income tax expense for rate-making purposes only the amount of such taxes actually paid with the use of these benefits. This terminology is in accord with general usage.

[5] The phrase "cost of capital" is here used as including, in addition to interest and preferred stock dividends, the return allowed on common equity although such return may not be "cost" under a literal definition of that word.

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capital secured from outside sources through bonds, preferred stock and equity securities.[6]

In including the deferred tax reserve in Panhandle's capital structure at 1½%, the Commission adopted the principles and policy which it had set forth in its Opinion No. 342, rendered on March 7, 1961, in *Northern Natural Gas Co.*, 25 F.P.C. 431, concerning liberalized depreciation, and which it had thereafter applied to accelerated amortization in *Kansas-Nebraska Natural Gas Co.*, Opinion No. 343, 25 F.P.C. 448. Since the rationale of the Commission's present order is set forth in Opinion No. 342, we are reprinting the relevant portion of that opinion as an appendix to this brief.

On September 27, 1962, a panel of the court of appeals (former Chief Judge Miller and Judge Burger, with Judge Bazelon dissenting) sustained Panhandle's

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[6] Before the Commission (R. 31) and the court below (No. 16,479, Pet. Br. 26), Panhandle contended, as an alternative, that its minimum permissible rate of return was 6.41% reflecting a return of 5.45% on the deferred tax credit. This 6.41% figure was devised to arrive at the same revenue before federal income taxes (*i.e.*, the same cost to ratepayers) as would result if the company were to raise equivalent funds by the sale of securities according to its existing ratio of bonds, preferred stock and common equity. The difference in net return to the company from these alternative methods of securing such capital results from the fact that interest costs on debt capital are deductible from taxable income for federal income tax purposes, and since there are no interest costs incident to the use of deferred tax reserves, taxes (which must be allowed ahead of return) are higher on income derived from such funds than they would be on capital which includes conventional interest-paying debt. At the corporate income tax rate of 52 percent, to realize $1 in net return, the company must receive $2.0833 in revenues.

Panhandle apparently has abandoned this alternative contention in its present petition.

contention. On the Commission's petition (Pet. 8), the case was re-argued before the court *en banc* (Pet. App. 47a) on December 15, 1962. On March 15, 1963, the panel's opinions were withdrawn (Pet. 8) and a majority of the court, in an opinion by Chief Judge Bazelon (in which Judges Edgerton, Fahy, Washington and Wright concurred), held that the Commission's decision was well within the range of its administrative discretion under the Natural Gas Act and was not prohibited by the Internal Revenue Code (Pet. App. 16a–22a). Judge Miller (joined by Judges Danaher, Bastian and Burger) dissented, on the grounds that the Commission's decision (1) failed to give the corporate taxpayer the benefits contemplated by Congress in enacting the revenue provisions in question, and (2) contravened prior rulings of the Commission sustained by the District of Columbia Circuit in relevant part in *City of Detroit* v. *Federal Power Commission, supra*, 97 App. D.C. 260, 230 F. 2d 810 (Pet. App. 22a–46a).

Panhandle thereupon petitioned for rehearing *en banc*, "suggesting" (Pet. 9) that Judge Edgerton should not have participated in the *en banc* proceeding and requesting that the decision "be vacated and rehearing *en banc* be granted in order to provide Judge Edgerton's successor an opportunity to participate in the decision." The petition also reargued the merits. On April 18, 1963, this petition was denied by unanimous vote of the Court *en banc* (Pet. App. 48a).

On March 22, 1962, Judge Edgerton had notified the President of his intention to retire from active duty, when his successor was "ready to be sworn in" (Pet.

9). On August 16, 1962, the President sent to the Senate his nomination of Mr. Carl McGowan as circuit judge "vice Henry W. Edgerton retiring." Cong. Rec. August 16, 1962, p. 15690 (daily ed.). The Eighty-seventh Congress adjourned without confirming the nomination. The nomination of Mr. McGowan "vice Henry W. Edgerton, retiring" was sent to the Eighty-eighth Congress on January 15, 1963. Cong. Rec. January 15, 1963, p. 359 (daily ed.). The Senate confirmed on March 15, 1963. Cong. Rec., March 15, 1963, p. 4150 (daily ed.). The President signed Judge McGowan's commission on March 27, 1963. On April 22, 1963, Judge McGowan took the oath of office.

ARGUMENT

The decision below approves, as well within agency discretion, a Federal Power Commission holding, in a rate case, that an overall rate of return on investment which includes a return of 14% on capital generated by the company's "normalization" of its income taxes is consistent both with the standards of the Natural Gas Act and the objectives of the tax statutes. This holding that the regulatory approach adopted was within the permissible range of choice is clearly correct and involves no conflict among the circuits. Nor, obviously, was the decision below invalidated by the participation in the *en banc* rehearing of a judge who had announced his retirement, effective when his successor was "ready to be sworn in", where the successor's appointment was confirmed the day the decision was announced but his commission was not signed by the President and he was not sworn in until later.

1. This case presents a narrow facet of a much mooted problem in fixing utility rates—how to treat income taxes which have been computed by using the rapid write-off of plant investment permitted by Sections 167 and 168 of the Internal Revenue Code. Section 167 permits larger deductions during the early years of the useful life[7] of each plant unit than would be available under the conventional "straight-line" method of depreciation accounting,[8] with resulting lesser percentages during later years. Section 168 permits deduction, in five equal annual installments, of investment in facilities certified as "emergency", thus writing off investment in those facilities much more rapidly than under "straight-line" accounting, with zero deductions during the remaining life of such facilities. Under both sections, with respect to a single unit of plant, there would result an increase of deductions (and hence a decrease in taxable income) during the early years followed by a decrease in deductions (and an inverse effect on taxes) during the later years of its useful life.

The first question, upon which there has been great divergence of policy among regulatory agencies, is whether rates fixed upon the basis of cost of service should cover only the taxes actually being paid, or whether allowance should be made for "normalized taxes", *i.e.*, taxes computed by the use of straight-line

[7] Under the straight line method the total investment in a plant unit is, in effect, charged off to operating expenses in *equal* annual installments over the anticipated life of the unit.

[8] The average life of depreciable plant of natural gas pipelines is in the neighborhood of 30 years.

accounting, with the excess (in the early years) of such normalized taxes over the tax amounts actually paid being accumulated in special "deferred tax" reserve accounts maintained for the purpose of absorbing any amounts by which the actual taxes in later years may exceed normalized taxes. Until needed for that purpose, such amounts, as part of the company's capital, are available to be invested in new plant or plant replacement, *i.e.*, "plowed in."

A further question arises where normalization has been followed long enough so that the amounts in the "deferred tax" accounts constitute a substantial part of the company's total capital available to be invested in used and useful plant. That question relates to the allowance of return on a corresponding part of the total investment in used and useful plant. Some regulatory bodies have required that it be subtracted from the rate base;[9] some have included it in the rate base, but with a zero return;[10] and still others have included such capital without assigning it any specified rate of return, thus making it impossible to be sure that they have not, in effect, allowed it a return

[9] *E.g., Public Service Company of New Hampshire* v. *State*, 102 N.H. 150, 153 A. 2d 801, 806; *City of Alton* v. *Commerce Commission*, 19 Ill. 2d 76, 165 N.E. 2d 513, 520-522; *Southern Indiana Gas & Electric Company*, 38 P.U.R. 3d 177, 180 (Ind.); *Cumberland & A. Gas Co.*, 36 P.U.R. 3d 321, 331 (Md.); *Wisconsin Fuel & Light Co.*, 12 P.U.R. 3d 254 (Wisc.).

[10] *E.g., Empire District Electric Co.*, 23 P.U.R. 3d 45, 49-53 (Kan.); *Ohio Fuel Gas Co.*, 25 P.U.R. 3d 207 (Ohio)—Ohio however subsequently switched to flow through, *Cincinnati Gas & Electric Co.* v. *Public Utilities Commission*, 173 Ohio St. 473, 184 N.E. 2d 84, 85; *Ohio Edison Co.* v. *Public Utilities Commission*, 173 Ohio St. 478, 184 N.E. 2d 76, 81.

equal to that allowed on the capital acquired by normal means of private financing.[11]

As the Fourth Circuit summed up the situation in *Cities of Lexington* v. *Federal Power Commission*, 295 F. 2d 109, 114 (C.A. 4):

> It is obvious that we are confronted in this case with a problem in a special field which requires the exercise of expert skill that has been generally entrusted by state and Federal legislation to administrative regulatory tribunals whose decisions, in the absence of abuse of discretion, should be followed by the courts. * * *.

The Federal Power Commission, with the approval of several courts of appeals,[12] has permitted but not required normalization.[13] And, in all cases where it has passed upon the matter, it has allowed a rate of return of 1½% with respect to capital generated by normalization. It is this latter determination which is challenged here.

A. Petitioner's principal argument in support of its position that the Commission is required to allow a "full return" on capital generated by normalization rests on its assertion that such a benefit to its stockholders is compelled by the legislative history of Sec-

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[11] *E.g.*: *Washington Water Power Co.*, 33 P.U.R. 3d 88, 94 (Idaho); *Washington Public Service Commission* v. *Washington Water Power Company*, 33 P.U.R. 3d 468, 474–475, 492 (Wash.).

[12] *Supra*, p. 4.

[13] The entire subject of normalization vs. flow-through, and the rate of return on capital generated by normalization, if normalization be continued, is currently under re-examination by the Commission. *Alabama-Tennessee Natural Gas Co.*, 28 F.P.C. 586. See the Commission's petition for rehearing *en banc* below, at 16–22.

tions 167 and 168. That history, like the language of the sections, admittedly makes no reference to the manner in which taxes computed thereunder by regulated companies should be treated for rate-fixing purposes. But, it is contended, the avowed purpose of the sections was to induce investment in new facilities, and the sections were made applicable to both regulated and unregulated industries alike. Since an unregulated business availing itself of either type of rapid tax write-off could, *if competition permitted it to do so*, use the savings to increase the dividend-producing assets of the company, this option, it is argued, should also be available to any regulated company choosing to utilize the write-off.

The short answer is that merely because a tax benefit is made available to both regulated and unregulated businesses alike does not mean that regulated businesses *pro tanto* cease to be subject to regulation. Thus, it would hardly be contended that if Congress reduced the general corporate tax rate, as the President has proposed, regulated companies could continue to have their rates set on the basis of taxes calculated at the previous higher rate merely because unregulated companies could, if economic conditions permitted, retain the difference between the taxes they would have been required to pay under the old rates and those due under the new.

In the case of the unregulated industries, tax benefits, like other cost reductions, need not be earmarked; the forces of competition determine whether savings will be passed on to the stockholders in dividends, set aside in a reserve, reinvested in new plant, or utilized to enhance the company's competitive position through

a reduction in prices. The underlying premise of the regulatory process, on the other hand, is that the interplay of competitive forces is inadequate to assure determinations consistent with the public interest. Accordingly, while a regulated company is entitled to charge rates sufficient to recover its cost of service, including a fair return on its invested capital, it has a concomitant obligation to operate with all reasonable economy, with such savings as are effected—whether as a result of action by management or of tax benefits provided by the government—serving to reduce the cost of service. See *El Paso Natural Gas Co.* v. *Federal Power Commission*, 281 F. 2d 567, 573, (C.A. 5), certiorari denied *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912.[14]

It follows that a general Congressional purpose to make tax benefits available to both regulated and unregulated taxpayers cannot be converted into a mandate that the stockholders of a regulated company benefit at the expense of the rate payers. A *fortiori* it does not mean that the stockholders must receive the same return on capital generated (without cost to the company) as the indirect result of such tax benefits as they do with respect to capital raised through corporate financing. Significantly, the conclusion of

[14] In the *El Paso* case the court of appeals approved the Commission's action in permitting normalization by companies using liberalized depreciation on the assumption that the use of liberalized depreciation resulted in a tax deferral rather than a tax savings. The question of the return on capital generated thereby was not presented since the parties had stipulated to a 6 percent return for El Paso's transmission property and the Commission had fixed no rate of return on its well-mouth property, allowing it instead an amount equal to special tax savings (an action which the court set aside).

the court below, *i.e.*, that no Congressional purpose to benefit producers to the exclusion of consumers is reflected in the legislative history (Pet. 19a), is in complete accord with the views of the only other circuit to pass upon this matter. See *El Paso Natural Gas Co.* v. *Federal Power Commission*, *supra*, at 572 ("We think there is nothing in the legislative history that would warrant our concluding that Congress intended the * * * rapid depreciation provisions of the Revenue laws to amend or modify the express language of the Natural Gas Act * * *".) [15]

Nor can it successfully be contended that the Commission's determination failed to take account of the ultimate Congressional objective of stimulating investment in new plant. For the Commission not only pointed to the fact that there were a number of "material advantages" inherent in "the use of deferred taxes to supply a portion of the company's capital requirements" which would tend to induce additional investment [16] but, as further inducement, allowed peti-

[15] As the court below indicated, its language in a previous opinion in *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (C.A.D.C.), suggesting that Congress intended to benefit the regulated taxpayer rather than the consumer was made in the context of whether the Commission could properly include depreciation reserves in a company's rate base, and no issue was there involved as to the proper return on such funds. It is axiomatic that a decision of a court of appeals *en banc* resolving an alleged conflict of a decision by one panel with a prior decision of another panel of the court, provides no necessity for resolution of conflict by the Supreme Court.

[16] "* * * The substantial sums involved are readily available without resort to the market, and such additions to capital serve to reduce the company's debt ratio. The acquisition of plant by use of deferred taxes provides additional security not subject

tioner a 1½% return on the plant secured by use of funds generated by normalization, even though these funds were derived from the rate payers at no cost to petitioner. The court below properly held that these were substantial incentives to utilization of the tax write-offs for reinvestment purposes.[17]

B. Petitioner attempts to bolster its argument for a "full return" on deferred taxes by referring (1) to earlier Commission statements suggesting a Congressional purpose to provide benefits for the regulated company, rather than its customers, and (2) to the subsequent introduction of several bills which, according to petitioner, have amended the *Federal Power Act* to require the Commission to pass the benefits of liberalized depreciation directly to electric utility rate payers ("flow-through"). But the Commission's views as to the objectives of particular tax laws are surely subject to revision in the light of additional experience and understanding. Nor does the fact that Congress

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to lien on which new loans can be based, perhaps at lower interest rates than would otherwise be possible. Furthermore, deferred-tax funds accumulated between rate cases and invested in plant may, during that period, increase the company's earnings. Finally, the accumulation of deferred taxes increases the company's funds available for expansion without issuing additional common stock [fn. omitted]." Appendix, *infra*, p. 3).

[17] The possibility that petitioner may nevertheless refuse to utilize liberalized depreciation if it does not receive the return it demands, does not invalidate the Commission's determination, if it is otherwise reasonable. Certainly, in order to carry out the policy of the tax statutes, the Commission is not required to pay petitioner or any other company its asking price. As the court below stated (Pet. 21a), there is no indication that Congress bestowed any benefits upon regulated companies "beyond those necessary to provide incentives to investment * * *."

failed to enact new legislation indicate that it was necessarily ratifying the views of the Power Commission. See *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 348–349. It could just as well be argued that Congressional inaction constituted ratification of the diametrically opposed views as to the regulatory effect of the same two tax statutes simultaneously adopted by the Interstate Commerce Commission. *Amortization Accounting for Emergency Carrier Facilities*, 284 I.C.C. 9 (1951), affirmed, 299 I.C.C. 463 (1956); *Increased Freight Rates, 1956*, 298 I.C.C. 279, 289; *Accounting for Federal Income Taxes*, 24 Fed. Reg. 1401 (1959).

2. By the terms of his letter, Judge Edgerton's retirement from regular active duty was not to take effect until his successor was "ready to be sworn in." A federal judge has the right to retain his office so long as he chooses (Const., Art. III, Sec. 1), a right which may be ended only by impeachment or voluntary act of the judge himself. *Johnson* v. *United States*, 79 F. Supp. 208, 210 (Ct. Cl.). Thus, Judge Edgerton unquestionably remained qualified to participate in *en banc* consideration until Mr. Carl McGowan was "ready to be sworn in." Whatever the precise moment that condition was met, it certainly could not have been before March 27, 1963, when the President signed Judge McGowan's commission. Since the decision on rehearing was issued on March 16, 1963, the present case manifestly does not come within the scope of *United States* v. *American-Foreign SS. Corp.*, 363 U.S. 685, which held that Judge Medina should

not have participated in an *en banc* decision *after* his retirement had become effective.

Panhandle's position is that Judge Edgerton became ineligible the moment he indicated his intention not to remain as a "permanent" active member of the court (Pet. 20).[18] This contention that a judge becomes "inactive" and hence ineligible to sit on *en banc* matters when he announces his intention to retire in the future has neither good sense nor legal support. Judge Edgerton wisely exercised his right to retire from regular active duty in such a way as to prevent the unfortunate void which was presented in the *American Foreign Steamship* case, *supra*, p. 16.

His action conformed to the suggestion by Circuit Court Judge Kaufman in *United States* v. *Allocco*, 305 F. 2d 704, 712 (C.A. 2), certiorari denied, 371 U.S. 964, that such problems of judicial appointments "could be alleviated by suggesting to judges that they notify the President considerably in advance of antic-

[18] Panhandle raised no objection to Judge Edgerton's participation in the order granting rehearing *en banc* or to his sitting for the argument on December 15, 1962, long after Judge Edgerton's letter to the President and the President's nomination of Judge McGowan. Both these events had been widely publicized. Thus, to entertain Panhandle's present attempt to have Judge Edgerton disqualified would contravene what Mr. Justice Harlan has so aptly referred to as "an obviously sound policy of preventing litigants from abiding the outcome of a lawsuit and then overturning it if adverse upon a technicality of which they were previously aware." *Glidden Co.* v. *Zdanok*, 370 U.S. 530, 535. Cf., *Pacheco* v. *People of Puerto Rico*, 309 F. 2d 759, 760 (C.A. 1); *Fisher* v. *United States*, 170 F. 2d 273, 277, 278 (C.A.D.C.), certiorari dismissed, 338 U.S. 883; *In re United Shoe Machinery Corp.*, 276 F. 2d 77, 79 (C.A. 1).

ipated resignations or retirements." Petitioner's view would defeat the obvious advantages of such a smooth transition and deprive the court, for an indefinite period, of the service of one of its members in all cases calling for adjudication *en banc*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1963.

APPENDIX

Opinion No. 342

NORTHERN NATURAL GAS COMPANY, DOCKET NO. G–19040; PERMIAN BASIN PIPELINE COMPANY (NOW MERGED INTO NORTHERN), DOCKET NO. G–19041

OPINION AND ORDER DETERMINING RATE OF RETURN, DEFERRING DECISION ON ALLOCATION OF SYSTEM COSTS, DISALLOWING PROPOSED INCREASED RATES, DIRECTING PAYMENT OF REFUNDS, AND PERMITTING SUBSTITUTION OF LOWER INTERIM RATES

(Issued March 7, 1961)*

Commissioner Stueck *concurring.*

Chairman Kuykendall *dissenting in part.*

Before Commissioners: Jerome K. Kuykendall, Chairman; Frederick Stueck, Arthur Kline and Paul A. Sweeney.

This pipeline rate case is before us under the interim order procedure we have applied in recent cases providing for hearing and decision of particular issues susceptible of being decided prior to the completion of the entire hearing. It arose on the filing on June 26, 1959, by Northern Natural Gas Company (Northern) and its then wholly-owned subsidiary, Permian Basin Pipeline Company (Permian), of proposed increased rates under Section 4(d) of the Natural Gas Act (Act).

Return on deferred income tax accruals. The question of the proper treatment, in fixing rates of return,

*Designated Commission Opinion No. 342. Rehearing denied by order issued April 20, 1961.

of amounts accumulated in a deferred tax account by reason of a company's election to use liberalized depreciation, as provided in Section 167 of the Internal Revenue Code, has not yet been determined by us. The increasing importance of this question is indicated by the extent of these tax accruals. In Northern's case, as shown above, they amount to in excess of eight million dollars. Based on reports by the companies to the Commission, it appears that the amount of such accruals in the year 1959 by natural-gas pipeline companies subject to Commission jurisdiction aggregates some $39,000,000; and total accruals by such companies to date approach $110,000,000. The question of how to treat these accruals is now directly before us in the present Northern proceeding and a determination must now be made that will affect other proceedings before us and those that will arise in the future.

Our previous determinations with respect to the treatment of liberalized depreciation have not dealt with the computation of rate of return but rather the question of the normalization of taxes. That is, whether a natural-gas company should be permitted to compute its income taxes for rate-making purposes on the basis of normal straight-line depreciation while using the liberalized depreciation method permitted by Section 167 in its tax returns. As compared with straight-line depreciation, the liberalized method provides higher depreciation deductions, resulting in lower taxes, during the early part of the life of a given property, while lower deductions and higher taxes result in the later years of the life of the property. The total depreciation deductions available to a company over the entire life of a facility and the total tax results of such deductions are the same using either method or a combination of the two. The comparative advan-

tage provided by the statute allowing liberalized depreciation is that it defers to the later life of a given property a portion of the taxes on income that would be payable in the early years under straight-line depreciation, and gives the company the use of such moneys in the interval.

In the *Amere* case,[5] the company and others filed a petition requesting us to issue a declaratory order to remove uncertainty relating to the treatment of liberalized depreciation. We affirmed our presiding examiner who concluded that the tax allowance to be included in the company's cost of service should be normalized to conform to the straight-line depreciation methods normally used under our Uniform System of Accounts, but that any portion of the tax allowance not actually paid in a given year, that is, the deferred taxes, should be reserved in a special account to cover the amounts by which future taxes would be greater than the normalized taxes reflected in rates. This treatment of liberalized depreciation distributes the tax and rate effects of depreciation expense equitably over the productive life of a facility and implements the Congressional intent to allow regulated industries, like other industries, thus to provide all or at least a portion of the additional capital needed for desired expansion.

Order No. 203, 19 FPC 826, put these conclusions into effect by amending the Uniform System of Accounts to include a new Account 266,[6] Accumulated Deferred Taxes on Income, to be credited with amounts by which income taxes paid were lower than normal because of the use of liberalized depreciation and correspondingly debited when taxes become higher

[5] *Amere Gas Utilities Co., et al.*, 15 FPC 781.

[6] Redesignated Account 281, effective January 1, 1961.

than normal.[1] We have thus allowed companies such as Northern to accumulate substantial sums in these deferred tax accounts and to invest these amounts in company facilities. The further question now presented is what return, if any, should the gas industry subject to our jurisdiction be allowed to earn on the portion of its capital investment so accumulated.

The position taken by the staff in this and other proceedings is that the accumulated deferred tax funds should be included as a part of the capital structure of the company at a zero rate of return. Staff argues that it would be erroneous to exclude Northern's accumulated deferred taxes from a factual statement of company capital, even though it does not constitute actual debt liability, since these funds, which were supplied by the consumer, are available for any corporate purpose except dividend payments, including investment in facilities on which the company would expect to be allowed a rate of return. Accordingly, staff contends that this amount may appropriately be included as debt in determining the relative proportions of debt and equity. Furthermore, it contends that such amount should be included at zero cost since the consumer provides these funds through the payment of rates at no cost to the company. Under staff's approach, the percentage of debt capitalization would be increased to 55.34 percent and the over-all cost of debt would be reduced from 4.01 percent to 3.88 percent. This would leave the same return of 2.15 percent on debt including deferred taxes and would reduce the over-all return to 6.22 percent.

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[1] This same treatment is accorded deferred taxes accumulated using accelerated amortization for tax purposes, as permitted by Section 168 of the Internal Revenue Code. Order No. 174, 13 FPC 968, April 21, 1954; *Panhandle Eastern Pipeline Co.*, 13 FPC 53, Opinion No. 269, April 15, 1954.

Northern, on the other hand, takes the position that it should be permitted to invest the tax accruals in facilities, which would become a part of its rate base, without including such investment as a part of its capital structure and without requiring any reduction in the rate of return to take account of the earnings from such facilities.

Northern argues that the funds represented by tax reserves are not contributed by nor do they belong to the customer, who under prescribed accounting procedures pays the same amount for income taxes whether or not the company takes advantage of the liberalized depreciation provisions of the Internal Revenue Code. If the company owns the funds, says Northern, the company's profitable use of such funds intended by Congress, including even their possible investment in non-regulated business, should not be precluded by regulatory action. Northern suggests that without the prospect of earning a return on the funds so provided, there would be little reason for the utility management to elect a rapid depreciation. It further suggests that allowing such funds to earn a return might improve a natural-gas company's financial standing and reduce its costs of financing, thereby benefitting its customers. Northern would thus use a capitalization excluding the deferred tax item composed of debt 54.5 percent, preferred stock 13.5 percent, and common equity 32 percent. Applying a 10.5 percent rate of return on equity to this capital structure would result in a return to Northern of 6.34 percent computed as follows:

	Ratio	Cost	Return
	Percent	*Percent*	*Percent*
Debt	54.5	4.01	2.19
Preferred stock	13.5	5.88	.79
Common equity	32.0	10.5	3.36
Over-all return			6.34

The use of liberalized depreciation by companies subject to Federal or state regulation has been the source of much litigation. Many jurisdictions have taken the view that a regulated company may not include in its cost of service any larger amount for taxes than the amounts actually paid by it. The effect of this method, commonly referred to as the flow-through method, is to pass on to the ratepayers immediately all savings accruing as a result of the use of liberalized depreciation. Other jurisdictions have taken the view that normalization of taxes should be permitted. As stated above, we took this view in our decision in the *Amere* case, *supra*, and adhered to it in our opinion in the *El Paso*[8] and *United Fuel*[9] cases. See also *Panhandle Eastern Pipe Line Company*, 13 FPC 53, Opinion No. 269, dealing with the treatment of accelerated amortization under the provisions of Section 168 of the Internal Revenue Code.

In those jurisdictions which have taken the view that normalization of taxes should be permitted there has been a divergence of views as to how the accumulated tax funds should be treated. Some have been of the view that the amount of accumulated deferred taxes should be deducted from the rate base.[10] Others, including this Commission in the *Panhandle* case, *supra*, have been of a contrary view. Some jurisdictions have adopted the view, urged by our staff, that the accumulated deferred taxes be included as a part of the capital structure at a zero percent rate of re-

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[8] *El Paso Natural Gas Company*, 22 FPC 260.

[9] *United Fuel Gas Company*, 23 FPC 127.

[10] See, for example, *City of Alton* v. *Commerce Commission*, 19 Ill. (2d) 76, 165 N.E. (2d) 513, 522. (This is also the position of the Civil Aeronautics Board.)

turn.[11] In New York, the Public Service Commission has held that the benefits of liberalized depreciation should be divided between the ratepayers and the company and has permitted the company to earn a small rate of return on the moneys accumulated from deferred taxes.[12]

Although we have not previously been confronted with this precise question, some aspects of it have been raised in two cases decided by us which have been subsequently appealed to the courts. In both of these cases, the court affirmed our view that normalization of taxes should be permitted. In the *City of Detroit case*,[13] an appeal of the *Panhandle Eastern Pipe Line Company* decision, *supra*, the Court in discussing the question of whether the accumulated deferred taxes should be deducted from the rate base said:

> Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of the deferred taxes to accrue after the five-year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit sub-

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[11] See, *Re Empire District Electric Company*, 23 PUR 3d, 45 (Kansas); *Re Michigan Gas & Electric Company*, 24 PUR 3d, 278 (Michigan); *Re Ohio Fuel Gas Company*, 25 PUR 3d, 207 (Ohio); *Re Pacific Power & Light Company*, 34 PUR 3d, 36 (Oregon).

[12] In *Re Central Hudson Gas & Electric Corporation*, 28 PUR 3d, 317, 329 (1959).

[13] *City of Detroit* v. *F.P.C.*, 230 F. 2d 810 (CADC 1955).

> stantially from Section 124A. This statute, unlike the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms the petitioners. We think this is the result sought by Congress.

In the *El Paso* case,[28] an appeal of the *El Paso* decision, *supra*, the court in discussing our treatment of liberalized depreciation said:

> * * * It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequences of rate regulation. * * *
>
> * * * Therefore, we approve the Commission's treatment of the "saving" resulting from using the declining balance method of depreciation for tax purposes but computing its taxes for rate making purposes on the straight line method of depreciation, placing such "savings" in a special reserve to be used to equalize tax payments in later years. These amounts can never represent added return to the company because of the restriction as to their use. * * *

Although the question of what consideration should be accorded the amounts in the deferred tax accounts was not directly before either of these courts, it would seem that, as urged by Northern, the *City of Detroit*

[28] *El Paso Natural Gas Company* v. *F.P.C.*, 283 F. 2d 567 (CA 5, 1960).

case supports its point of view, while the *El Paso* case would seem to support the staff's view.

It is true that the *City of Detroit* case dealt with accelerated amortization only and the *El Paso* case with liberalized depreciation, and different statutes having a different legislative background are involved. We believe it wiser not to attempt to distinguish between these two statutes but to adopt the same view as to all tax accruals, whether obtained from use of Section 167, dealing with liberalized depreciation, or Section 168, dealing with accelerated amortization.

The *Panhandle* (City of Detroit) case was considered by us shortly after the enactment of Section 168. At that time, neither we nor the courts were fully aware of all of the consequences which would result if moneys in the deferred tax accounts were considered as belonging solely to the company. Thus, the statement in the above quotation from the *City of Detroit* case that to permit the company to use the funds for income-producing purposes would not result in higher rates to the consumer has on more careful consideration been disclosed to be erroneous.

If we were to adopt the view urged on us by Northern and the apparent view of the court in the *City of Detroit* case that moneys in the deferred tax account were the company's money and that it was entitled to all income produced from such moneys, it would be necessary to include in the cost of service an additional sum of 108.33 percent (the ratio which the 52 percent corporate income tax rate bears to the amount of 48 percent retained by the taxpayer) of the amount earned on such moneys for the payment of Federal income taxes. To illustrate this point, in the present case if the $8,375,740 in Northern's deferred tax account is neither deducted from the rate base nor included in the capital structure at less than the 6¼

percent rate of return prescribed for Northern, Northern will presumably earn on this money at the allowed rate of 6¼ percent a sum of approximately $523,500.00. However, this will increase its actual Federal income taxes by $567,125.00. Since Northern is entitled to include its actual taxes in its cost of service, the ratepayer would be required to pay this additional sum and would be penalized in this amount by reason of the fact that Northern took advantage of liberalized depreciation.

In the case of those companies operating in states having corporate income taxes, an additional amount would have to be included in the cost of service as an allowance for state income taxes.

Furthermore, our staff argues that if Northern, instead of obtaining these sums through use of the liberalized depreciation, had borrowed this amount on the market at the prevailing rate, the entire amount of interest would have been deductible for tax computation purposes and the amount of taxes included in the cost of service reduced. Thus, assuming that Northern had borrowed this money at 5 percent, its interest cost of $418,800 (5 percent of $8,376,740) would have been a further deduction in the computation of its income taxes, resulting in a lowering of the amount of Federal income taxes to be included in its cost of service by $218,780 (52 percent of $418,000). Although we consider it unrealistic to assume that a company would borrow as senior debt all of the moneys needed by it, and that it would be more fair to consider that additional moneys would be obtained without substantial change in the existing ratio between debt and equity, it is entirely possible that in some instances all of the money would be borrowed. In such cases, the use of liberalized depreciation would require higher rates to be paid

by the ratepayer unless the rate of return allowed on the deferred tax moneys was fixed so that the combined return and associated taxes would be less than the return in the event the moneys were raised through the issuance of bonds or other debt securities.

Since use of liberalized depreciation without either deducting the accrued tax deferrals from the rate base, or taking them into consideration in fixing a rate of return requires the ratepayer to pay more than he would be required to pay if liberalized depreciation were not used, we must reject the company's position.

While we thus believe it is unnecessary to reject Northern's contention we must for equally sound reasons reject the contention of our staff that the accrued deferred taxes should be included in the capital structure at zero percent interest. The treatment suggested by staff would deprive the company of any earnings from the accumulated deferred taxes and would have the same practical effect as though the amount of deferred taxes were excluded from the rate base. This would deprive the company of most of the benefits arising from use of liberalized depreciation. Northern and other companies appearing before us have stated that if this is done that no valid reason exists for continuing to take advantage of the liberalized depreciation statute and that they may return to straight-line depreciation in the computation of their Federal income tax liability. Experience has shown that this is not an idle threat. Many, probably a majority of the companies regulated by commissions which have required that the benefits accruing as a result of the use of liberalized depreciation be passed on to the ratepayer, either by adoption of the flow-through method, or by requiring that the accrued deferred taxes be deducted from the rate base,

have ceased to take advantage of Section 167 of the Internal Revenue Act and have returned to straight-line depreciation in the computation of their income taxes.[6]

It is obvious that Section 167 affords definite advantages over the use of straight-line depreciation in that it lowers the amount of taxes currently payable. The use of the moneys not currently paid to the Treasury as taxes is a definite material advantage to the person having the use of such moneys. To adopt a policy which would give all of this advantage to the ratepayer and none to the company, and which, as experience has shown, will very probably result in the failure of the company to use liberalized depreciation, would be extremely shortsighted on our part.

In our view, the best solution to this problem is to divide the benefits of liberalized depreciation between the regulated company and the ratepayer. In dividing these benefits between the ratepayer and the company, we are guided by the principles that it is our duty to protect the consumer and adopt rate-making principles which will assure the lowest possible rates. Accordingly, we believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive

[6] Many electric companies over which both this Commission and state commissions have accounting or rate jurisdiction, whose principal operations are in a state that has required flow-through or deduction from the rate base for rate-making purposes have notified this Commission that they are no longer taking advantage of liberalized depreciation under Section 167. We are advised that a majority of the regulated companies in such states have ceased to use liberalized depreciation.

to continue to use liberalized depreciation, and not return to the use of straight-line depreciation in the computation of its income taxes. How much of a return should be allowed on the moneys in the deferred tax account to assure their continued use, is largely a matter of judgment based upon such factors as our knowledge of the money market, and our estimate as to what course most regulated companies will elect to pursue in the future. After careful consideration of all of the various factors involved; we are of the opinion that a return of 1.5 percent on moneys in the deferred tax account is a sufficient incentive to a regulated company to induce it to take advantage of the provisions of Section 167. We are further of the opinion that any figure appreciably lower than this will probably cause the company to return to the use of straight-line depreciation with its corresponding loss of benefits to the ratepayer.

Assuming a 10.5 percent return on equity, the allowance of a 1.5 percent return on the deferred tax account moneys results in a return of 6.25 percent to Northern as compared with a return of 6.34 percent if we allowed the company the same return on the tax moneys as it earns over-all, or a return of 6.22 percent if the staff view of a zero percent return on the deferred tax moneys were adopted.

Although our decision to allow a return of 1.5 percent is largely a matter of judgment as to what return we believe necessary to serve as an incentive to induce Northern to continue to use liberalized depreciation, it is supported by various computations. If, having allowed Northern a return of 6.25 percent, it should decide to go into the market to borrow money instead of raising it by use of the liberalized depreciation provisions of the income tax law, it

would probably have to pay in the neighborhood of 4.5 percent to 5.0 percent for its senior debt money under present market conditions. This would result in a net return to existing stockholders of 1.25 percent to 1.75 percent[a] on the borrowed money. To allow less than 1.5 percent return on the deferred taxes would mean that it might be more profitable for Northern's stockholders to enter the money market and borrow this money rather than take advantage of the provisions of Section 167.

We have stated earlier that it is probably neither fair nor realistic to assume that Northern will borrow all of this money. Accordingly, we have considered what would happen assuming that Northern raised its money in any one of several different ways. For purposes of illustration we have shown on the attached table the return to the company and the cost to the ratepayer of raising capital from average industry sources.[b] From this example it is apparent that the cost to the ratepayer if Northern would use straight-line depreciation and raise its capital through ordinary industry sources would be $716,000 more per year than if it used liberalized depreciation, while the increased benefit to the company stockholders would be only $150,000. (This increased benefit would, of course, go to more stockholders since the example assumes the raising of additional equity). Consideration of this and other similar examples lends support to our conclusion that a figure of 1.5 percent provides a reasonable, but not excessive, incentive to Northern.

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[a] This is a rough computation only, and the actual net return to the stockholders might be slightly higher.

[b] This illustration of 60 percent debt, 10 percent preferred stock and 30 percent common equity is very close to the average capital structure of major pipeline companies.

Apart from earnings, the use of deferred taxes to supply a portion of the company's capital requirements has certain material advantages. The substantial sums involved are readily available without resort to the market, and such additions to capital serve to reduce the company's debt ratio. The acquisition of plant by use of deferred taxes provides additional security not subject to lien on which new loans can be based, perhaps at lower interest rates than would otherwise be possible.[*] Furthermore, deferred tax funds accumulated between rate cases and invested in plant may, during that period, increase the company's earnings. Finally, the accumulation of deferred taxes increases the company's funds available for expansion without issuing additional common stock. It thus gives the existing stockholders the entire benefit of any earnings from the new investment. Our conclusions, giving due consideration to all the factors involved, is that these advantages, taken with a net return of one and one-half percent, constitute a reasonable and sufficient incentive to the pipeline industry to use liberalized depreciation for tax purposes and secure for its customers the substantial savings made possible by the statute. This mutually beneficial result gives such effect to the purposes of the tax statute as is appropriate within the principles of regulatory law expressed in the Natural Gas Act.

Commissioner Stueck *concurring*, filed a separate statement.

Chairman Kuykendall *dissenting in part*, filed a separate statement.

[*] To the extent that lower interest rates result, this will also benefit the consumer.

STUECK, Commissioner, *concurring:*

I concur in the action taken by the majority of the Commission in this case to permit an order to be forthcoming. However, I do so reluctantly since I am not fully convinced that the one and one-half percent rate of return allowed on funds realized by deferment of taxes provides a sufficient incentive to carry out the intent of Congress to stimulate business activity.

KUYKENDALL, Chairman, *dissenting* in part:

I dissent from the conclusion that

> In our view, the best solution to this problem is to divide the benefits of liberalized depreciation between the regulated company and the ratepayer. In dividing these benefits between the ratepayer and the company, we are guided by the principle that it is our duty to protect the consumer, and adopt ratemaking principles which will assure the lowest possible rates. Accordingly, we believe that the major portion of the benefits accruing from the use of liberalized depreciation should go to the ratepayer, and the company should be allowed only so much of the benefits accruing from the use of liberalized depreciation as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation, and not return to the use of straight line depreciation in the computation of its income taxes.

It is our duty to apply the law (that is section 167 of the Internal Revenue Code), and not our discretion, to the facts before us. We have only the legislative powers which Congress has given us, and have no power to amend section 167, distributing as we see fit the advantages given to the taxpayer by this statute.

We should, as the language of the Court of Appeals in the *City of Detroit* case, *supra*, quoted by the majority, clearly states, allow the taxpayer the full advantage of the tax deferral, but without any disad-

vantage to the ratepayer. The fact that the court did not mention, and may not, in fact, have considered the possible tax deduction arising by virtue of payment of interest on borrowed money does not alter the principle involved.

My colleagues seem to assume that the amounts accumulated through the deferral of taxes would otherwise be obtained through borrowing, or that, in any event such sums should be treated as the equivalent of debt capital. In my opinion, this is error. Such funds actually are as much or more akin to equity than to debt capital. We recognized this fact in our Order No. 203 amending our uniform system of accounts, 19 FPC 826, when we considered the possibility of setting up the reserve account as earmarked surplus. Our prohibition against payment of dividends from these funds would seem to presuppose that such sums are included in surplus.

The fairest and most logical assumption is that these amounts would have been obtained from the various sources in the same proportion as all of Northern's other capital has been obtained. On this premise, a rate of return of 3.27075% on the capital accumulated from deferred tax accruals will yield Northern the same income it would get if such capital had been obtained through conventional financing and not only will not harm the ratepayer, but will actually benefit him substantially. This is shown by the attached schedule.

Note that by use of conventional financing, it would cost the ratepayers $891,261 to supply Northern with a rate of return of 6¼% on an amount equal to the accumulated deferred income taxes, of which $273,982 would be the net return to Northern. On the other hand, a return of 3.27075% on the capital from deferred tax accruals would yield the same net return to Northern at a cost of only $569,882 to the rate-

payers. Thus the ratepayers would save $321,379, or 36% of the cost of conventional financing, and Northern would receive 100% of what it would receive if conventional financing were used.

The majority quote the following languages from the *El Paso* case, *supra*:

> It is the obligation of all regulated public utilities to operate with all reasonable economies. This applies to tax savings, as well as economies of management. The net result of this, of course, is that such savings as are effected are passed on to the consuming public. This we consider to be the natural and necessary consequence of rate regulation.

This language was used by the court in discussing and disposing of tax savings (percentage depletion and intangible well drilling costs) and does not pertain to tax deferrals, and consequently has no relevance in the majority's opinion.

The following sentence in the *El Paso* opinion, *supra*,

> These amounts can never represent added return to the company because of the restriction as to their use,

does not, I believe, mean that the company cannot invest and earn on the sums accumulated for deferred taxes. It is undisputed that Sec. 167 was enacted specifically for that purpose. In the *El Paso* case, the problem presented to the court was whether liberalized depreciation constituted a tax saving or a tax deferral. There was no issue, such as we have here, as to the effect of a lack of interest payments to be used as a tax deduction, which deduction would be present if conventional financing were used.

What do the words "restriction as to their use" mean? The only restriction I know of is the restriction we have placed against using these funds for the

payment of dividends, and that must be the restriction to which the court was referring. In my opinion, the court used the word "return" as a synonym for "dividends."

The views I have expressed herein are, I believe, consistent with section 167 and its legislative history, with the only two court decisions which are controlling (*City of Detroit* and *El Paso, supra*), and are fair to the rate payer; yet they do not constitute a usurpation of the constitutional power of Congress.

NORTHERN NATURAL GAS COMPANY AND SUBSIDIARIES

CONSOLIDATED CAPITALIZATION—DECEMBER 31, 1959

Total capitalization

		Ratio	Cost*	Return at 6¼%
		Percent	*Percent*	*Percent*
Debt	$243,311,000	54.5	4.01	2.18545
Preferred Stock	60,412,500	13.5	5.88	0.79380
Common Equity	142,650,748	32.0	10.22	3.27075
	$446,374,248	100.0		6.25000

Deferred Federal Income Taxes were $8,376,740 at Dec. 31, 1959

Deferred taxes

			Return	Tax allowance at 108% of taxable income	Annual cost to ratepayers	Tax paid	Interest paid	Preferred dividends paid	Net return to common equity
$8,376,740 capital from normal industry sources:									
Debt	$4,565,329	54.5%							
Preferred Stock	1,130,860	13.5							
Common Equity	2,680,557	32.0							
	$8,376,740	100.0%							
6¼% return			$523,546	$807,715	$891,261	$807,715	$183,069	$66,495	$273,982
2 $8,376,740 capital from deferred tax accruals: 6¼% return			523,546	555,430	1,088,976	555,430			523,546
3 $8,376,740 capital from deferred tax accruals: 3.27075% return			273,982	295,900	509,882	295,900			273,982

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No. 277

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

REPLY BRIEF FOR PETITIONER

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September 20, 1963

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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REPLY BRIEF FOR PETITIONER

I

Although it urges the Court to deny certiorari, the Commission does not and can not deny:

1. That the issue of the propriety of including in the capitalization of a natural gas company its tax deferrals accumulated under Sections 167 and 168 of the Internal Revenue Code at a return of only 1.5 percent involves a matter of great and continuing importance;

2. That although Section 167 was enacted in 1954 and Section 168 was enacted in 1950, the question of

the proper treatment of these accumulated tax deferrals is still, to use the Commission's own words (Br. in Opp., p. 9), "a much mooted problem in fixing utility rates," thereby resulting in great uncertainty and making it impossible for natural gas companies to make informed decisions on tax matters of great importance; and

3. That the Commission's present position, approved by the court below, represents a departure from the Commission's prior and consistent rulings which the court of appeals had approved in *City of Detroit* v. *F.P.C.*, 230 F. 2d 810, 822 (D.C. Cir. 1955), *cert denied*, 352 U.S. 829, (1956),[2] and on which Panhandle had expressly relied in electing to use Sections 167 and 168.

II

Having in effect conceded the importance of the question of the treatment of the accumulated tax deferrals, the Commission presses for the denial of certiorari on the ground that the decision below is clearly correct. But such a determination by the Court is more appropriately made after full briefing and oral

[1] The Commission is less than candid when it undertakes to bedevil the fact that the full return has been allowed by several state Commissions on these accumulated tax deferrals (see Br. in Opp., pp. 10-11). There is no question that in the absence of assignment of any "specified rate of return" (Br. in Opp., p. 10) a full return is allowed automatically on the accumulated tax deferrals.

[2] The Commission's reference to the pending proceeding in *Alabama-Tennessee Natural Gas Co.* (Br. in Opp., p. 11, fn. 8) and the concomitant possibility that it might adopt yet a third position on the treatment of these accumulated tax deferrals serve to emphasize the need for a definitive ruling by this Court in order finally to put the problem at rest.

argument by the parties, rather than on the limited presentation now before the Court, particularly in view of the importance of the matter. Moreover, one need not look any further than the sharp division in the court below and the vigorous dissenting opinion of Judge Miller to appreciate that the decision of the majority below is, to say the least, far from clearly correct. To the contrary, the decision below, we submit, is erroneous and the arguments advanced by the Commission in support thereof are without merit or substance.

1. The Commission's argument, that Sections 167 and 168 are nothing more than tax reduction provisions, the benefits of which a regulated company is no more entitled to retain than it would be to retain the benefits of, say, a reduction in the general corporate tax rate (Br. in Opp. p. 12), is unsound. As both the Commission and the court conceded in their opinions below, the legislative history of Sections 167 and 168 plainly reveals that these Sections are not general tax reduction provisions but were enacted for the specific and special purpose of encouraging all taxpayers, regulated as well as unregulated, to make increased investments in plant and equipment. And, as shown in our Petition (at p. 13), Congress plainly understood that it was essential to the achievement of this purpose that the benefits of the tax deferrals resulting from the use of these provisions should be available for retention by the taxpayer companies. The allegation (Br. in Opp. pp. 12-13), unsupported by the record, that in certain competitive situations an unregulated company may believe it better business to use its temporary tax deferrals to lower prices, does not indicate that the Congressional purpose has not been satisfied as far as most other unregulated companies are concerned. Nor does it justify the denial of the bulk of these benefits to a regulated company as here sanctioned by the court below.

2. Allowing a regulated company to retain the full benefits of Sections 167 and 168 does not mean, as the Commission further argues, that "regulated business *pro tanto* cease to be subject to regulation." (Br. in Opp., p. 12). Rather, allowing these companies to retain these benefits permits Sections 167 and 168 to operate as Congress intended. Not only are Sections 167 and 168 *not* "rate-reducing provisions as to regulated companies" (Pet. App., p. 43a), but "unlike the Natural Gas Act itself [they are] not for consumer benefit . . ." and have "a different public policy [which] should be given effect as intended by Congress" (*City of Detroit, supra*, 230 F. 2d at 822).

3. Nor is it correct to say that "the shareholders of a regulated company benefit at the *expense* of the ratepayers" (Br. in Opp., p. 13; see, also, p. 11) (emphasis supplied). It is true that the rates paid by the ratepayers are not reduced by virtue of the taxpayers' use of Sections 167 and 168, as they might be if these Sections were general tax reduction provisions. But such a comparison is misleading since, as already shown, Sections 167 and 168 are in fact not general tax reduction provisions.

It is far more pertinent to compare the rates paid by the ratepayers absent the taxpayer company's election to utilize Sections 167 and 168 with those paid when the company utilizes these Sections and retains the benefits thereof. As pointed out in our Petition (at pp. 16-17), the ratepayers in these circumstances pay virtually the same rates as they would pay if the company had elected not to use Sections 167 and 168. As the court below correctly found in *City of Detroit, supra*, 230 F. 2d at 822:

> ". . . the solution of the Commission [allowing the taxpayer company to retain the full benefits of Section 168] does not result in higher rates to the consumer. It simply does not operate to

reduce them. It aids Panhandle, but neither aids nor harms [the ratepayers]."

4. In this regard, it should be noted *El Paso Natural Gas Co. v. FPC*, 284 F. 2d 567 (5th Cir. 1960), *cert. denied, sub nom. California v. FPC*, 366 U.S. 912 (1961), does not provide any support for the Commission's position, much less does it justify the heavy reliance placed upon it by the Commission (see Br. in Opp., pp. 13, 14).[3] For, in that case, the Commission, as it implicitly admits (Br. in Opp., p. 13, fn. 14), had allowed a full return on the company's accumulated tax deferrals. And while the Fifth Circuit disagreed with the Commission's treatment of tax benefits under other sections of the Internal Revenue Code not involved here, it expressly affirmed the Commission's action with regard to the tax deferrals accumulated as a result of the company's use of Section 167. See 284 F. 2d at 573-574.

Thus, when viewed in the context of the court's decision, it is apparent that the language from *El Paso* quoted by the Commission (Br. in Opp., p. 14), does not support the Commission. Quite the contrary, that language constitutes recognition (a) that Sections 167 and 168 concern only the taxpayer companies and the United States Treasury, without, in any way, involving the consumer or Commission regulation under the Natural Gas Act, and (b) that the principles of rate regulation which the Commission also attempts to invoke (Br. in Opp., p. 13) are inapplicable.

[3] The Commission's bald assertion that *City of Detroit* did not involve any issue as to the proper rate of return on the accumulated tax deferrals (Br. in Opp., p. 14, fn. 15) ignores the showing in our Petition (at pp. 12-13, fn. 12) demonstrating the invalidity of the same assertion by the courts below. Recitation by the Commission, in the teeth of this demonstration and without even mention thereof, does not render the assertion any the more valid.

5. The Commission further contends that it had provided sufficient incentive to induce the taxpayer companies to utilize Sections 167 and 168 (Br. in Opp., pp. 14-15).[4] But this contention overlooks the fact that Congress in enacting Sections 167 and 168 had determined the quantum of the incentive and made it equally applicable to every segment of America's industry, including the natural gas industry. In these circumstances, the Commission's view that a lesser incentive would be sufficient, does not operate to authorize it—or the court below—to reduce the incentives prescribed by Congress.[5] Any change in the incentives provided by Sections 167 and 168 is, of course, for Congress, not the Commission or the court below, to determine.

6. Finally, the Commission seeks to justify the abandonment of its prior consistent position with the explanation that "the Commission's views as to the objectives of particular tax laws are surely subject to revision in light of additional experience and understanding" (Br. in Opp., p. 15). It fails to mention that such a revision would operate not just prospectively but retroactively against the numerous companies, including Panhandle, which had participated

[4] The incentives the Commission would allow are in fact inadequate (see Petition pp. 17-18). This error of the Commission is due in part to its failure to recognize that Congress intended the taxpayer company not only to utilize Sections 167 and 168, but to invest the resulting tax deferrals in new plant and facilities (see Petition pp. 15-16). Thus Congress sought to spur investment, whereas the Commission misunderstood the Congressional intent as merely seeking to spur the companies to file for the tax benefits.

[5] Since Panhandle is seeking only the incentives granted to it by Congress, the Commission's slanted comment that it "• • • is not required to pay petitioner or any other company its asking price" (Br. in Opp., p. 15, fn. 17) is uncalled for and entirely unjustified.

in its earlier proceedings and had taken action in reliance on this prior position. Furthermore, whatever may be the merits of such an argument with regard to matters committed to the Commission's expertise, the determination of the Congressional objectives in enacting Sections 167 and 168 plainly is not a matter within the Commission's special expertise.

As a Federal Power Commissioner recently stated in addresing himself to the scope of the power of an administrative agency,

> "* * * A regulatory agency must abhor any action which goes beyond the limits of its statutory authority. *I know of no statute which confers power on a regulatory agency to write its own legislation when it feels the existing laws are inadequate.* * * * Jurisdiction is established by law, and remains as thus established until changed by the legal processes available through Congress. *Any reach for powers beyond those which are clearly set forth by the statute* would represent a breach of public trust and endanger our whole concept of utility as practiced in this country." (Address of Commissioner Harold C. Woodward before the Independent Natural Gas Association, September 17, 1963).

Moreover, in addition to the fact that the Commission's prior reading of the Congressional objectives has been affirmed upon independent analysis by various courts of appeals (see Petition pp. 5-6), it should be noted that the only "additional experience" since the Commission's adoption of its earlier position has been the lack of any Congressional action indicating disagreement with the Commission's consistent determinations. Indeed, as shown in our Petition (at p. 14), Congress has been advised on several occasions of the decisions of the Commission and the courts; and

although it has amended Sections 167 and 168 in other respects, it has not amended or otherwise changed the basic provisions of the Sections. Since the validity of these earlier holdings was thus approved and affirmed, it is apparent that this "additional experience" undermines, rather than supports, the Commission's reversal of position.

III

Similarly without merit is the Commission's attempt to support the participation and casting of the decisive vote by Judge Edgerton in the *en banc* decision.

1. The fact that a federal judge has the right under Article III of the Constitution to retain office so long as he chooses (Br. in Opp., p. 16) is wholly irrelevant.[6] The problem here presented concerns the propriety, in the circumstances here involved, of Judge Edgerton's participation in *en banc* proceedings under a Congressional statute (28 U.S.C. 46(c)) which, in authorizing these extraordinary proceedings, specifically defines the composition of an *en banc* court. Thus, the issue here presented is statutory rather than constitutional in nature. Cf. *United States* v. *American-Foreign S. S. Corp.*, 363 U.S. 685, 688 (1960).

2. The Commission's further contention that Judge Edgerton's action was appropriate "* * * to prevent the unfortunate void which was presented in the *American Foreign Steamship* case * * *" (Br. in Opp., p. 17), and to permit "a smooth transition" (Br. in Opp.,

[6] It is well settled that a retired judge is nonetheless a judge within Article III entitled to all its protections. See *Booth* v. *United States*, 291 U.S. 339, 350-1 (1934); *Glidden Co.* v. *Zdanok*, 370 U.S. 530, 584 (1962). Otherwise, of course, he could not sit in conventional judicial proceedings.

p. 18) have already been rejected by this Court, at the urging of the Government,[2] in the *American Foreign Steamship* case. In that case, the Court of Appeals had sustained the propriety of Judge Medina's participation in *en banc* proceedings specifically on the ground that it was appropriate in order to avoid the need to "suspend [the court's] judicial task." *See American-Foreign S. S. Corp.* v. *United States*, 265 F. 2d 139, 154 (2d Cir., 1959). And this Court, in reversing on the Government's petition, expressly noted that "* * * if the statute is to be changed, it is for Congress, not for us, to change it" (363 U.S. at 691).

3. Finally, contrary to the Commission's assertion (Br. in Opp., pp. 17-18), there is no correlation between Judge Edgerton's action and the suggestion of Judge Kaufman in *United States* v. *Allocco*, 305 F. 2d 704, 712 (2d Cir., 1962), *cert. denied*, 371 U.S. 964 (1963). Not only is there nothing in Judge Kaufman's opinion relating to court of appeals *en banc* proceedings but the issues before him were entirely different. The *Allocco* case concerned the President's power, under Article II, Section 2 of the Constitution, to make recess appointments, the status of a district judge sitting under such an appointment and the latter's authority to preside at, and to impose sentence in, a criminal proceeding.

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[2] See Brief for the United States in No. 138, October T. 1959 at pp. 13-14, 18-19.

[3] The Commission implies (Br. in Opp., p. 17, fn. 18) that Panhandle had waived its objection to Judge Edgerton's participation in the *en banc* decision by not raising it until its petition for rehearing. This implication flies in the teeth of *Glidden* v. *Zdanok*, *supra*, where this Court rejected a similar argument of the Government. Here, as in *Glidden*, "the statute claimed to restrict authority is not merely technical but embodies a strong policy con-

CONCLUSION

For the foregoing reasons as well as those set out in the Petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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erning the proper administration of judicial business" (370 U.S. at 535-536; cf. *Western Pac. R. Corp.* v. *Western Pac. R. Co.*, 345 U.S. 260, fn. 20 (1953)) and hence Panhandle's objection may be considered "on direct review even though not raised at the earliest practicable opportunity" (370 U.S. at 536; see, also, *United States* v. *Allocco*, *supra*, at 706-708).

Moreover, the fact is that Panhandle did raise its objection at the earliest practicable opportunity. The Commission's contrary suggestion assumes Panhandle's position to be based solely on Judge Edgerton's advice to the President of his intention to retire (Br. in Opp., p. 17). Although this alone may well have been sufficient to have disqualified Judge Edgerton from further participation in *en banc* proceedings, Panhandle's position here is based, in addition, on the further fact that the *en banc* decision was issued at a time when the condition Judge Edgerton had imposed was on the verge of fulfillment, if not actually fulfilled, i.e., his successor had been confirmed by the Senate. Plainly, therefore, Panhandle's raising of the objection in its petition for rehearing was at the earliest practicable opportunity.